# PRIVATIZATION:
# PROBLEMS OF IMPLEMENTATION
# IN EGYPT

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# Privatization in Egypt: Problems of Implementation

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## SUMMARY

This study aims to investigate to what extent the views of the managers of the enterprises to be privatized are a barrier to smooth implementation of privatization as opposed to other problems. Accordingly, the research tackles two main issues:

- Identification and analysis of the major problems encountered in the implementation of the Egyptian privatization programme and at which level these problems exist while proposing different approaches to tackle them, and
- views of public sector top and middle-level managers regarding the main issues of privatization

The study relies upon a literature survey, interviews with stakeholders, a survey of managers' attitudes and several illustrative case studies.

A model of "good practice" for the smooth and effective implementation of privatization has been designed. Practice in Egypt has then been studied and compared with the "good practice" model.

Lack of strictness and firmness in implementing the announced privatization programme has been found to be a characteristic of Egyptian practice. This is partly attributable to the inadequacy of the programme and partly to the different obstacles to implementation. The main obstacles are doubtful desirability of privatization on the part of managers at different implementation levels, resistance of stakeholders, inadequacy of the legal framework governing privatization, redundant labour, lack of an efficient monitoring system allowing for accountability, inefficient marketing of privatization, ineffective communication, insufficient information at different levels and problems related to valuation and selling procedures.

A large part of the thesis is concerned with SOE (State Owned Enterprise) managers' attitudes on and understanding of the privatization (appraised through surveys). Although most managers have stated their acceptance of privatization, many of their responses show that they do not accept selling SOEs. They understand privatization to include enterprise reform and restructuring, changing procedures and giving more authority to company executives, but not necessarily as selling SOEs. The majority of managers still see many issues that have to be addressed for smooth implementation of privatization e.g. insufficiency of information, incompleteness of legal framework, restructuring and labour problems.

The main contribution to knowledge of this thesis is the study of problems of implementing privatization in industrializing and developing countries especially managers' resistance to privatization as a major change, partly because of the threa it poses and partly because of lack of understanding of privatization and implications of operating private businesses. A programme for persuading managers and offsetting the unfavourable effects is recommended as an outcome of the study.

Five different phrases and words for the national Index to theses are: Egypt, privatization, implementation of privatization, problems of implementing privatization and managers' attitudes towards privatization.

*Thanks to all who helped me*
*Make a dream come true*
*Thanks to my*
*Dad, mum and sister*
*Thanks to my*
*Husband and children*
*Ahmed, Alia & Adham*

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# List of Contents

**Contents** **Page**

# List of Tables

# List of Figures



# List of Boxes

# Average Foreign Exchange Rates of USD against EGP for the Period 1990 to 2001[1]

| | 1990 | 1991 | 199 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 000 | 001 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **January** | 2.57 | 2.89 | 3.32 | 3.334 | 3.369 | 3.398 | 3.399 | 3.399 | 3.425 | 3.43 | 3.78 |
| **February** | 2.59 | 2.96 | 3.32 | 3.338 | 3.375 | 3.4 | 3.398 | 3.395 | 3.425 | 3.445 | 3.78 |
| **March** | 2.63 | 3.25 | 3.335 | 3.337 | 3.374 | 3.401 | 3.4 | 3.397 | 3.425 | 3.45 | 3.85 |
| **April** | 2.65 | 3.34 | 3.33 | 3.335 | 3.38 | 3.405 | 3.401 | 3.393 | 3.425 | 3.46 | 3.85 |
| **May** | 2.67 | 3.33 | 3.315 | 3.433 | 3.38 | 3.41 | 3.401 | 3.393 | 3.425 | 3.465 | 3.88 |
| **June** | 2.69 | 3.34 | 3.32 | 3.34 | 3.383 | 3.407 | 3.399 | 3.395 | 3.425 | 3.47 | 3.895 |
| **July** | 2.7 | 3.32 | 3.315 | 3.35 | 3.385 | 3.4 | 3.4 | 3.397 | 3.43 | 3.5 | 3.923 |
| **August** | 2.71 | 3.31 | 3.33 | 3.355 | 3.379 | 3.399 | 3.397 | 3.397 | 3.43 | 3.55 | 4.2 |
| **Septembe** | 2.74 | 3.31 | 3.32 | 3.35 | 3.385 | 3.4 | 3.398 | 3.4 | 3.43 | 3.64 | 4.265 |
| **October** | 2.79 | 3.32 | 3.315 | 3.355 | 3.389 | 3.398 | 3.398 | 3.405 | 3.43 | 3.74 | 4.267 |
| **Novembe** | 2.82 | 3.32 | 3.325 | 3.36 | 3.394 | 3.396 | 3.398 | 3.403 | 3.43 | 3.75 | 4.27 |
| **December** | 2.83 | 3.33 | 3.325 | 3.365 | 3.398 | 3.4 | 3.399 | 3.403 | 3.425 | 3.77 | 4.33 |
| **Average *** | **.699** | **3. 5** | **3.3 3** | **3.354** | **3.383** | **3.401** | **3.399** | **3.98** | **3.4 7** | **3.556** | **4.0 4** |

* Approximated to three decimal places

Source : Societe Generale Bank

[1]Excluding 1998

## Abbreviations Used

AC : Affiliated Company

Aprox. : Approximately

BOD : Board of Directors

CAAA : Central Agency for Accounting and Auditing

CEO : Chief Executive Officer

Co. : Company

CMA : Egyptian Capital Market Authority

DAF : Director of Administration and Finance Department

EERP : The Egyptian Economic Reform Programme

EMS : Egyptian Mail Service

ESA : Employee Shareholders' Association

GA : General Assembly

GATT : General Agreement on Tariffs and Trade

GDP : Gross Domestic Product

GNP : Gross National Product

GOE : Government of Egypt

HC : Holding Company

IBTCI : International Business and Technical Consultants, Inc.

IDC : Integrated Development Consultants, Inc.

ILO : International Labour Organization

IMF : Internatonal Monetary Fund

In./ Non-In : Industrial / Non-Industrial

IPO : Initial Public Offering

JVB (s) : Joint Venture Banks

JVC (s) : Joint Venture Companies

Mgmt : Management

MPE : Minister of the Public Enterprises

PE : Public Enterprise ( same as state-owned enterprise)

PEO : Public Enterprise Office

Quest.: Questionnaire

SFD : Social Fund for Development

SOE : State-owned Enterprise

TOR : Terms of Reference

# Chapter One
# Introduction

## 1.1 The Research Problem and its Rationale

This chapter is a brief introduction to the study. It first identifies the research problem and states the research objectives. It then presents the main research questions followed by an overview of the hypotheses and how they are tested. The importance of the study is then explained. Finally the overall outline of the study is presented including a brief summary of how the research is designed and the methods and procedures of research employed[1].

In 1991 the decision to "go ahead" with the privatization of State Owned Enterprises (SOEs)[2] was taken (Al-Ahram, Feb., 1991). Since then the Government has initiated several privatization programmes to transfer an increasing number of units to the private sector. The rate of implementation has varied from one year to the other, but on the whole the process has been comparatively slow.

The study seeks to determine whether the obstacles to implementation lie at the policy level, at the industry level or at the company level. Accordingly, the study provides an overview of the privatization process in Egypt, investigates some of the possible accompanying problems and examines the extent to which SOE managers' beliefs and attitudes to privatization form a barrier to smooth implementation of privatization. The major issues investigated in this study are:

- The extent to which managers are a barrier to smooth implementation of privatization.
- Whether the Egyptian Government is sufficiently committed to the privatization policy.
- Adequacy of the present legal framework governing public enterprises.
- Company restructuring problems.

[1]The methodology has been discussed in more detail in Chapter Five.

[2]State-Owned Enterprises (SOEs), Public sector enterprises and Public Enterprises (PEs) refer to public sector entities that have separate legal personalities that have accounts expenses and revenues and where the government acts as a manufacturer or trader of goods or services.

- Problems in valuing companies prior to sale.
- Problems in marketing privatization to different stake-holders.
- Labour resistance and labour rehabilitation problems.

Based on the definition of the research problem, the study has two main objectives:

- to provide an overview of the privatization process in Egypt comparing it with an idealized "good practice" model of privatization, and identifying problems of implementation; and
- to identify managers' understanding of and attitudes to the privatization process and the implications of those attitudes for implementation.

These objectives have led to the formulation of the basic research questions and hypotheses.

## 1.2 Research Questions and Hypotheses

This study is designed to fill part of the gap in knowledge about privatization implementation in Egypt. It identifies and analyses the attitudes of managers of SOEs and assesses how they affect the implementation process as opposed to other problems. It also discusses the extent of Government commitment to the privatization policy and evaluates problems of implementation.

Opinions and attitudes of managers of SOEs on different privatization issues are investigated both as key informants that have many years of experience in these companies and as implementers of privatization whose favourable attitudes and cooperation are essential for the success of implementation. The study focuses on eight major problem areas using opinion surveys supported by case studies where appropriate. Based on the identification of the research problem presented above the basic research questions this study is seeking to answer are:

- What are the attitudes of managers of SOEs toward different aspects of privatization? To what extent do these attitudes hinder implementation of privatization?
- What are the major problems of implementing privatization in Egypt? At which level do these problems lie? Do implementers at other levels resist implementation or are there other problems?

- What are the recommended approaches to deal with each of the implementation problems?

To answer those basic questions, three general hypotheses have been formulated to guide the research:

- The attitudes and views of Managers of SOEs are a major obstacle to speedy privatization.
- The lack of strictness and commitment on the part of the Government in implementing the privatization programme is partly responsible for the slow rate of privatization.
- Other serious problems hindering implementation are the legal framework, restructuring, labour issues and asset valuation.

The study examines these hypotheses through (a) a questionnaire survey of senior and middle managers in SOEs, (b) a number of case studies, and (c) information from publications and interviews with government officials and senior managers on privatization policies and progress in Egypt.

The questionnaire survey serves two purposes. It provides evidence on the views, attitudes and understanding of managers which may constitute an obstacle to the implementation of privatization. It also provides the views of managers as "experts" with knowledge of SOEs and the privatization process, and therefore contributes to better understanding of the other reasons for the slow progress of privatization.

The questionnaires, as used in this survey, also give rise to two types of sub-hypotheses. One has to do with the distribution of responses for a given variable and the other has to do with the comparison of two or more groups in terms of the distribution of their responses for a given variable. An example of the first type of hypotheses is as follows:

> ***"With respect to the level of understanding of the term 'privatization' the distribution of all managers will be different from that which could be expected on a chance basis".***

This kind of hypothesis is tested by means of the Chi-square one sample test (Yamane, 1964). This test is carried out to ensure that the survey result can be interpreted with some confidence as a significant finding based on considered responses.

An example of the second type of hypotheses is as follows:

*"The level of managers' understanding of the term 'privatization' will differ according to whether the manager is a top-level or middle-level manager. "*

This second type of hypotheses is tested by means of the Chi-square test for two or more independent samples. Some contingency coefficients are also utilized (Feller, 1958). This test is intended to identify any differences in responses between managers at different levels and from different types of enterprises.

Theoretically, one should formulate sub-hypotheses to cover all questions in the questionnaires. In order to avoid repetition in formulating hypotheses, the three major hypotheses determined above are considered the main hypotheses of the study and each sub-hypothesis implied by a question is dealt with by the manner in which the results are tabulated in the relevant chapter. The evidence on the sub-hypothesis is used to form conclusions on the main hypotheses.

## 1.3 Importance of Research

This study is important in four respects:

- The study provides a detailed account of privatization in Egypt, including an assessment of the strengths, weaknesses, problems, opportunities, aims and practices. Such information should prove useful for managers, administrators and authorities. In view of the shortage of previous empirical research on privatization in Egypt, the findings of this study should make the implementers better able to discharge their responsibilities and to guide future action aimed at increasing the effectiveness of practice.
- It should furnish academicians and practitioners with first-hand information about the actual .situation of privatization in Egypt. This could be very useful for comparative purposes and perhaps for enlightening practice in other parts of the world.
- This study is also important because very little research work has been done, whether locally or internationally, to study attitudes of managers of SOEs and how they affect the privatization process.

- The continuous process of developing, assessing, and redesigning privatization approaches depends on a continuous flow of empirical data, especially from regions not previously investigated extensively. Primary data presented and assessed in this study should provide ideas and insights that might be of value for theorists.

## 1.4 Research Strategy, Methodology and Design

### 1.4.1 Introduction

This study aims to examine the privatization process in Egypt. Identification of problems, exploration of causes and effects and an assessment of different options are all important issues in examining the process. Of equal importance are the attitudes and opinions of managers at various levels regarding privatization. These attitudes could very well make or break the best policies of privatization. Therefore, one needs to understand the policies and also to understand the attitudes of those charged with the task of implementing the policies. Actual practice of privatization has to be analyzed in depth to see whether policies and attitudes stand the test of successful practice.

Privatization is a large multi-faceted topic with interrelated macro level, industry level and enterprise level aspects. A single piece of research cannot deal with all these aspects, at every level at the same time. The areas investigated by the study, the research strategy, and the methodology are outlined below.

### 1.4.2 Research Strategy

Choice of the appropriate methodology is the first problem that faces any researcher. Quantitative and qualitative methodologies both have their pros and cons. The choice of the appropriate approach is totally dependent on the nature of the research and required information.

Quantitative methodologies such as surveys have the advantage of enabling the researcher to generalize statements concerning the objects of the study through representative surveys and to later validate their results by standard statistical techniques (Archer, 1988). The conclusions one can draw from them are generally more reliable because they are based on evidence from a relatively large number of respondents who were chosen to represent the population using statistical methods.

Surveys also enjoy the advantage of possibility of repetition. They allow the researcher to repeat the same survey or statistical test on different groups of people. Comparisons between the different results could than be made to check whether the different groups are similar and therefore support the hypothesis or to explain any differences if the results are different.

The major disadvantage of using surveys is that in most cases it is not possible to get detailed answers or to follow up the initial responses. If a response is unspecific, it is not normally possible to clarify with the respondent. Another con of surveys is the possibility of biases. These biases could result from questionnaire design, leading respondents to answer in a certain way or from the choice of respondents themselves who could be more likely to respond in a certain way (Archer, 1988).

The qualitative methodologies such as case studies and interviews allow for a more detailed understanding of processes, causes and effects. They also help to examine what happens behind the scenes of different institutions, organizations and activities (Yin, 1993).

Using case studies allows for an in-depth analysis of the organization. It allows using multiple sources of evidence such as company records, interviews, observation, which allow the researcher to pursue certain issues and provides a holistic, fuller perspective to the investigation. Case studies can also be adapted to each individual case allowing for unexpected developments.

On the other hand information derived from case studies is, in most cases, very specific to the particular case being analyzed and cannot be generalized. The researcher has to use subjective judgement in arriving at conclusion and therefore the results are dependent on the researcher's knowledge and experience. Another disadvantage of case studies is that it is difficult to compare the results of different case studies and the possibility of using statistical analysis is very limited. Yin (1993) suggests ways in which such pitfalls can be reduced. Because of the advantages and pitfalls associated with surveys and case studies (and other qualitative methods such as semi-structured interviews) for collecting data, the two complementary approaches have been used in this study.

The researcher considered that the most appropriate method to assess manager's views is attitude surveys. Using an adequate sample would permit the researcher to reach generalizable results that can describe managers' views and attitudes on different aspects of privatization. Surveys would also allow the researcher to study different groups of managers in different types of companies in order to compare the results and identify any similarities or differences. In this study the researcher chose to use a stratified random sample to study views of senior and middle managers in industrial and non-industrial SOEs. The objective was to assess their views about issues related to privatization and whether and to what extent the attitudes of any or all of the examined groups could create obstacles to privatization. To the best of the researcher's knowledge the sample used for each group was representative of the population and allowed the researcher to reach generalizable results.

Closer, more detailed examinations at the enterprise level were also needed for complex, specific problems and issues such as restructuring and asset valuation. The researcher depended on in-depth case studies in three different companies, to study such problems more closely. The first study aimed to demonstrate how the Government Of Egypt (GOE) deals with the restructuring problem. The second case revealed how the labour restructuring problem is dealt with in practice and what the role of SFD is. It also presented the different labour compensation schemes and the extent of their success in a real-life situation. Further, it showed the costs involved and the problems that might arise in labour restructuring and how they could affect the company. The main purpose of the third case was to investigate whether valuation of sales is a problem hindering smooth implementation of privatization. The case demonstrated the methods of valuation and pricing mechanisms used by the GOE in practice.

Documents and records were examined where appropriate (in the case studies and in other parts of the research) to find relevant quantitative and historical data. Interviews with managers and government representatives were held to clarify certain issues that could not have been sufficiently clear if the researcher had only depended on written reports or published information.

A literature review was initially carried out to enable the researcher to understand the different aspects of privatization. This review has enabled the researcher to set out a framework or a model for "good" privatization practice and the different components and steps in it. There are three main stages in the privatization process: The policy stage at the macro level, the industry level stage and the enterprise level stage.

Full coverage and investigation at all three levels would be very useful. The researcher had to adopt a strategy that achieves this within the limited resources available and the time allowed. This strategy was composed of the following:

A) At the macro level, interviews were carried out with policy makers. This was supported by adequate access to documents and records related to the privatization process in Egypt. Hence the researcher was in a position to reasonably understand and analyze privatization policies and plans in Egypt.

B) At the industry and company levels, an attitudinal survey of managers of all companies affiliated to Law 203/1991[3] was carried out. The aim was to solicit views on the process, to identify problems of implementation and to identify options for action. This survey led to a clear statement of major problems hindering the privatization process in Egypt.

C) Thirdly, at the company level, a number of case studies were carried out to examine the problems associated with restructuring, labour and asset valuation.

It is clear from the above that the researcher has adopted a triangulation strategy with three main streams each suited to the level under study. Examination at the macro level allowed the researcher to gain a global view of the whole scene of privatization in Egypt. The surveys at the industry and enterprise level enabled the researcher to identify and assess the major problems of implementation at those levels how the attitudes of managers influence the process. Finally, case studies enabled the researcher to examine some implementation problems in more detail.

## 1.4.3 Research Methods Adopted

### 1.4.3.1 Literature Survey

Recent, relevant journal articles, research papers and books have been reviewed (See Chapter 2) to enable the researcher to formulate the research problem

[3]The new law for governance and managing of public sector enterprises.

more precisely, to formulate hypotheses and to design the field survey. It has also assisted the researcher in formulating a "good practice" model of privatization.

### 1.4.3.2 Field Work

#### 1.4.3.2.1 Interviews for Examination of Policies at the Macro Level

A number of interviews have been held with relevant parties to clarify the Government privatization policy and its latest developments, its relationship with the stock market and the role of the Social Fund for Development (SFD) in the privatization process. The interviewees were:

- The Public Enterprise Deputy Minister and his senior staff;
- The Public Enterprise Office Chairman and his staff;
- Managers at the Social Fund for Development in charge of absorbing unemployment caused by the privatization programme;
- Capital Market Authority officials;
- Brokers in the Stock Market; and
- Businessmen[4] (private sector).

Interviews were used in this study where it was felt more details and clarifications were needed. Although interviews in some cases allow for subjectivity, face to face contact has the advantage of allowing the interviewees to clarify their views beyond the limits of a written questionnaire. This phase of the study was most beneficial in attaining a clear understanding of privatization issues at the macro policy-making level.

#### 1.4.3.2.2 Attitude Survey at the Industry Level

To identify, understand and analyze managers' attitudes at the industry level, a general survey was carried out using two questionnaires:

- The first questionnaire was directed at CEO's of holding and affiliated companies.

[4]Several businessmen were interviewed to find out what their views were concerning privatization, methods of sale of PEs and their readiness to invest in such purchases.

❖ The second questionnaire was directed at middle-level managers in the affiliated companies.

At the outset of Chapter 5 which deals with the results of the attitude survey, a full account is given for sampling procedures, problems of attitude measurements, the construction of research instruments and how the research issues were embodied in the interviews. Also validity and reliability tests are explained together with how the hypotheses were formulated.

#### 1.4.3.2.3 Case Studies

Three case studies have been carried out to help illustrate three major issues associated with privatization implementation:

The Sheraton Hotel Sale Case ⟶ To help study valuation problems
The Egyptian Co. for Refractories Case ⟶ To help study restructuring problems
Alexandria Shipyard Co. Case ⟶ To help study labour issues

These case studies have been valuable tools to demonstrate how certain issues and problems were dealt with in actual practice in the Egyptian context. Although, the information derived from them cannot be generalized and is limited to the relevant companies, it gives an indication of the problems that might arise in similar companies and those in the same field.

The Cairo Sheraton Hotel and Casino was chosen as a candidate to study valuation problems because it was one of the early entities to be privatized, and where the sale had actually taken place. The case demonstrates problems encountered in the valuation of ongoing entities that are to be sold to anchor investors. The Egyptian Company for Refractories was chosen to study restructuring issues. This was mainly because it was one of the companies included in the earlier Government restructuring programme, where a study team was actually appointed and started working. Alexandria Shipyard Company was chosen to study labour restructuring because it was one of the main projects that the Social Fund for Development (SFD), in charge of offsetting privatization possible negative effects on labour of privatization, was undertaking. The case helps demonstrate both the role of the SFD and the problems encountered in labour restructuring.

Throughout the fieldwork in the three case studies the researcher sought information both written and spoken, company documents, magazines and newspapers. The following table describes the design of the case studies which was guided by the work of Yin (1993).

**Table 1.1: Case Study Design**

| Issues | Description | | |
|---|---|---|---|
| | **Case Study 1** | **Case Study 2** | **Case Study 3** |
| Level of analysis | Enterprise Level | Enterprise Level | Enterprise Level |
| Theoretical Framework | "Good Practice" Model developed by the researcher. | | |
| Issue analyzed | Restructuring of loss-making SOEs | Labour restructuring in SOEs | Valuation of entities to be sold |
| Identity of empirical field | Industrial sector: The Egyptian Company for Refractories | Industrial sector: Alexandria Shipyard Company | Non industrial sector: Cairo Sheraton Hotel & Casino |
| Research Method | Case Study: Analysis of a professional report | Case Study: Descriptive and explanatory | Case Study: Descriptive and explanatory |
| Data Collection Process | Field visits, interviews, direct observation and examination of company records. | | |
| Sources of information | Academic literature, business journals and newspapers, company documents and archives and company personnel. | | |

## 1.5 Plan of Research

Following this introductory chapter, Chapter 2 is a literature review of previous work on privatization and is concluded by a proposed "good practice" model of privatization, to which the Egyptian privatization programme is compared in later chapters. Chapter 3 describes the context for privatization in Egypt. It reviews the development and characteristics of the Egyptian public sector, its underlying rationale, performance of the sector and its contribution to the problems of the economy and government budget and debt. It then describes the development of the privatization policy and the major reasons behind it. Chapter 4 presents the structure of privatization in Egypt and then displays the successive Egyptian privatization plans and how far they were actually implemented. The chapter ends by identifying the possible problems hindering privatization that are to be discussed in later chapters. Chapter 5 presents the methodology of the attitude survey followed by the solicited attitudes and views of executives and managers of SOEs concerning the public sector and their orientation towards the privatization policy. Chapters 6 through 9 use the findings of the field survey and case studies in discussing different implementation problems. Chapter 10 is a summary of the attitudes of managers categorized into four different profiles. The final chapter summarizes the work and presents conclusions and implications of the study. The "good practice" model presented in Chapter Two is used in this concluding chapter in presenting the findings.

# Chapter Two

## Literature Review and Theoretical Framework

### 2.1 Introduction

This chapter reviews some of the previous relevant work on privatization with the objective of setting the scene for subsequent analyses and providing a benchmark for assessment of privatization in Egypt. Presentation of material will be divided to best serve this objective. The chapter starts by analyzing the meaning of privatization and then gives a brief account of increased state ownership of production worldwide after World War II and how privatization started in different parts of the world especially in the last two decades of the 20$^{th}$ century. Rationale for privatization and some opposing views are then outlined. Next, methods of privatization are discussed. Finally, drawing on the literature and privatization experiences in many countries a model of "good practice" is developed and presented to serve as a benchmark for evaluating aspects of privatization endeavors in Egypt.

Privatization is a large subject with a very large number of publications. It was beyond the scope of this study to review the whole of this literature and so the researcher limited herself to some of the studies which were relevant to understanding the privatization process in Egypt. Notably, these studies were in the areas of defining privatization, evidence on the performance of public sector companies and privatized enterprises and obstacles to privatization especially in middle income industrializing countries like Egypt. In addition, in view of the focus of this dissertation on SOE managers, some references on organizational change and how managers deal with such change especially in the context of privatization have been reviewed.

### 2.2 The Meaning of Privatization

Privatization is a comparatively new term. It is used to convey a variety of meanings. At the broadest level privatization refers to the introduction of market forces into an economy. According to the narrow definition of privatization it simply refers to selling publicly owned enterprises to the private sector. In between these two extremes, different levels and types of private sector involvement have been identified.

Vuylsteke (1988) defined privatization as " the transfer of commercially oriented State Owned Enterprises (SOEs), activities or productive assets of the government to total majority or minority private *control.*" By this he means it does not only mean the transfer of ownership from public to private hands, but it also includes leases and management contracts for SOEs and agencies involved in commercial activities, agriculture or manufacturing.

Donaldson (1995) states that privatization could include any transfer of ownership or control from public to private hands. He continues to state that a more exacting definition of privatization would require that the transfer be enough to give the private operators or owners substantive independent power. According to him this will often, although not always, imply majority ownership.

Ramandham (1989), in contrast with the definition of Donaldson (1988), defines privatization as "a wide continuum of possibilities between denationalization at one end and market discipline at the other." He does not confine privatization to the structural sense of who "owns" an enterprise, but rather describes it as "how far the operations of an enterprise are brought within the discipline of market forces" including "liberalization and deregulation". He presents the different methods of privatization in a diagram where he divides privatization into ownership, organizational and operational measures (Fig. 2.1). According to him privatization could also be described as the transfer of whole public firms, parts of firms or individual assets to private hands. This transfer could take place through sale, through changing it to private legal form or even through contracting out some supply tasks (Ramandham, 1989).

**Figure 2.1: Different Possibilities of Privatization**

Aston University

Illustration removed for copyright restrictions

*Source*: Ramandham, V.V. (1989), *Privatization in Developing Countries,* Routledge, London, UK.

Many authors (e.g. El-Nagar, 1989) also consider any form of changing publicly owned assets to business-oriented management a form of privatization. This would include profit-oriented management, debureaucratisation, denationalization and the adoption of employment and working conditions applicable to the private sector. It would also include any form of promotion of competition, reduction of scope of public services or privatization of public resources or revenue.

Kolderie (1986) holds that in spite of many articles and books written about privatization what is meant by the word still remains confused. For example, in Britain privatization refers to transferring to private parties the ownership of state industry that had been producing mainly for private buyers. In the United States privatization means more reliance on private producers for services for which government remains responsible. Kolderie (1986) distinguishes between two options: a) privatization of provision and b) privatization of production where the decision to provide a good or service results from a public policy decision, while production of the good or service is done by a private sector producer. The Government may decide that a good or service be provided but delegate the actual production to the private sector. In some cases, the private sector may supply a good or service, but a SOE may be a producer.

The following example will clarify four possibilities:

**Case I:** Both provision and production of service are public:

Cairo Governerate decides to assign more cleaning workers in the Eastern part of the city to cover the shortage in the area.

**Case II**: Provision is public but production of service is private:

The Government contracts Evergreen Cleaning Company to be in charge of cleanliness of the museum area streets.

**Case III**: Provision is private, production is public:

A private company distributes butter and oil. They contract a SOE to provide them with oil and butter which they package and distribute.

**Case IV:** Both provision and production of service are private (equivalent to full privatization):

A private bank decides to contract a company specialized in cleaning building fronts to clean its outside windows.

In summary the Government can privatize public provision, public production or both. Each of these Functions can be broken down again into several activities, (Table 2.1) which could be privatized partly or wholly.

**Table 2.1: Public Provision and Public Production**

| Public Provision | | Public Production | |
|---|---|---|---|
| Policy making | Subsidizing | Operation | Administering |
| Deciding | Franchising | Delivering | Selling |
| Buying | Regulating | Doing | |
| Requiring | | | |

*Source: Adapted from Kolderie, 1986.*

Privatization refers to the set of integrative policies and measures that aim to attain a more liberalized economy, based on competitive market forces. Hence it includes:

1. Denationalizing and selling Government-owned enterprises partly or wholly.
2. Operational measures such as leases and contracting out.

3. Laws, rules and regulations encouraging competition.

4. Adoption of a more liberal monetary and fiscal policy

This study is focused on the narrow meaning of the term privatization i.e. transfer of SOE ownership from public to private hands.

## 2.3 The Beginnings of Privatization

The origins of private ownership are as old as mankind. The desire to own, preserve and, later, extend one's land, house, car and even toy is born with each new baby. Ancient paintings and monuments in Egypt and in other parts of the world show landlords, merchants and craftsmen's shops as old as 4000 BC. Private professionals and service providers increased as towns flourished and specialization became more prevalent. During the Sixteenth and Seventeenth centuries the very first joint-stock companies started to emerge in a form very similar to what we see today [1].

As to public ownership of assets, it is as old as the origin of states. Along with the emergence of governments came the concept of public services, expenditures, resources and hence assets. Public roads, bridges, transportation means, parks, schools and hospitals spread everywhere. Departments were established, employees were hired and taxes were collected to start and preserve these organizations.

Revenue earning government-owned institutions working on commercial principles are a more recent concept. The state-owned entities were originally established to cover capital investment gaps, to generate funds to finance public services and to create job opportunities for continuously growing populations. As time passed more profit-making public institutions were needed and built in most countries. Governments started investing large amounts of money to build profit-making entities in all economy sectors whether industrial, construction or agricultural. The number of SOEs increased everywhere.

At the same time a strong trend towards socialism and government ownership was developing in many places. Nationalization moves started spreading in many countries especially in less developed ones. More and more private institutions were

[1]The Russian Company founded in Britain in 1553, followed by the East India Company in 1600 were among the first ones (Afify, 1991).

transferred to government hands increasing the number of profit-making public institutions not only in socialist countries like the Soviet Union, but also in countries like Egypt and Syria (during the Fifties).

According to the International Monetary Fund (IMF), public expenditure increased worldwide by 2 to 3 per cent annually, during the second half of this century, and at particularly high rates registered between 1960 and 1975. In the 90 countries the IMF tracks, 13 countries were spending as much as 30 per cent of their Gross Domestic Product (GDP) in the public sector in the early Seventies of the 20th century. By the end of the decade the number increased to 40 countries spending more than 30 per cent of their GDPs in the public sector. This growth of the public sector was characterized by an increase in SOEs especially in developing countries[1]. SOEs accounted for between 20 and 60 per cent of total investment spending in these countries (Berg, 1987).

By the mid Eighties SOEs were playing a major part in many developing countries. They accounted for 10 to 20 per cent of GDP in most of them with a dominant position in manufacturing. Eighty per cent of the value-added in manufacturing in Egypt for example was generated by state-owned enterprises. In Turkey the percentage was 50 and around 30 to 40 per cent in most of the other developing countries (Berg, 1987). The rationale for SOEs in most of these countries was mainly political. Ensuring availability of affordable products and at the same time creating jobs, were usually the main objectives regardless of what the costs or future implications were.

Although this increase in public sector companies continued, a U-turn in thinking began to gain ground as early as the 1950's mainly in some industrialized countries, for example West Germany and in a small way in the UK. Poor industrial relations records, non-commercial attitudes and limited concern for customer interests and needs were cited as major reasons for an increasing public attitude disapproving nationalization and favouring denationalization. A public opinion poll in January 1951 showed a 54% disapproval of nationalizing the British iron and steel industry while

[1]The number of SOEs in Mexico for example increased from 150 in 1960 to 400 in 1980 and probably around 600 in 1987. In Brazil the 150 SOEs in 1950 increased to at least 600 by the beginning of the eighties. In Tanzania the number of SOEs rose from 50 in mid 1960s to 400 in the late 1970s. The same happened in many other countries (Berg, 1987).

only 24% of the population approved. The iron and steel industry was actually nationalized in 1951 and was later denationalized gradually between 1953 and 1963. The steel industry was re-nationalized in the 1960s by the labour Government and then privatized in the late 1980s. In Germany the Electric and Mining Company shares were offered for public sale in 1959. Volkswagen, Veba and Lufthansa followed (Ramandham, 1989).

Fitzgerald (1988) states that many of the state-owned monopolies had eventually become "nothing but employment agencies, providing job havens for political cronies, defeated politicians, and retired military officers". The direct and indirect costs of SOEs became a burden on the governments and hence taxpayers of every country they were found in whether they admitted it or not. This fact started to be increasingly expressed and later asserted by most international organizations such as the World Bank and the IMF.

However, denationalization exercises between 1950 to 1980 were isolated, unrelated attempts which did not represent a concrete and deliberate programme in the UK or any other parts of the world. Actually they were accompanied by stronger and more popularly acclaimed nationalization moves worldwide. In general, public ownership of a range of productive activities were accepted or at least tolerated by the public and policy makers during this period.

One of the earliest appeals for an integrated program of privatization during this period appeared in the UK in Boyson (1971) which claimed that publicly controlled industries had failed in fulfilling their economic and social objectives and made a case for breaking up and selling nationalized industries and returning them to a competitive framework. It hailed the Volkswagen denationalization a model.

More authors and officials followed suit (Macvoy, 1989). The drive was both political and economic. In 1976, the Conservative Party in Britain issued the first document proposing privatization. It stated that, in some cases, it was more appropriate to sell public assets to private hands. Another document followed in 1977 stating that: "The long term aim must be to reduce the preponderance of state ownership and widen the base of ownership" (Ramandham, 1989). With the objective of making Britain a nation of homeowners and shareholders Conservative Governments in the 1980's, introduced a privatization programme which has been described as "popular" or even "worker capitalism", offering sales of stock in some SOEs and selling or giving away others to their employees (Fitzgerald, 1988).

Practical steps towards privatization began by contracting-out local authority services (such as street cleaning) and giving tenants of council houses the right to buy their homes. In 1982 and 1983 Amersham International, the National Freight Corporation, Britoil and Associated British Ports were privatized. In 1984 the program began to gain momentum and many companies were sold. Five per cent of British Petroleum was the start followed by British Aeroscope and Cable and Wireless. In 1984 Sealink, Inmos, Wytch Farm, British Gas, Enterprise Oil and Jaguar were sold (Kent, 1987). The British experience took shape as a new major phenomenon. The sale of British Telecom shares to 2.3 million individuals represented a turning point after which many public share issues were made and planned (including British Gas, British Airways, British Airports Authority, British Petroleum) (Kent, 1987).

Britain took the lead in the privatization revolution by transferring about one third of its nationalized work force, 600,000 employees, to the private sector through the sale of state-owned companies (Fitzgerald, 1988).

After 1981 the trend towards privatization accelerated gaining momentum in other parts of the world. In August 1986, the French National Assembly and Senate approved a general law, permitting privatization. The annex accompanying the law included the names of 65 companies and banking groups that were to be privatized and the method of privatization. The programme (worth $50 billion) was to be implemented over a five-year period. By June 1987, ten companies had been sold, increasing personal shareholders from 2 million to 5 million. Among the SOEs sold were three banks, an advertising company and a telecommunication firm. Within the twelve following months 50 per cent of the programme was actually implemented (Fitzgerald, 1988).

The Reagan Administration in the USA followed the same steps and, in 1986, started a privatization programme that reached $20 billion of asset sales in 1987. The Canadian Government committed itself to a $600 million privatization programme, besides contracting out more and more public services. A minister in charge of privatization was appointed in 1986 and the programme expanded (Kent, 1987).

By 1986 privatization plans and programmes had become a phenomenon not only in countries with right-of-centre governments like Colombia, Turkey and Chile, but also in countries with socialist governments like China, Eastern European countries (after the disintegration of the Iron Curtain), New Zealand, Spain, Australia and Mexico. Japan also developed a large privatization programme that completed the sale of 12.5 per cent of the government's shares in 1986 and 1987 (Kent, 1987).

Since the early 1990's, because of large debt burdens and an increasing budget deficit, there has been a growing trend towards privatization in developing countries also. International institutions such as IMF, USAID, the World Bank, the UK Department for International Development and its predecessors, the Commonwealth Secretariat and the United Nations, taking their cue from privatization programmes in industrialized countries, have originated or at least encouraged privatization as a tool for reducing public sector budget deficits and debt, curb the drain of national resources caused by loss-making public sector companies and improve their efficiency productive capabilities.

In Egypt, encouraging the private sector was given a great push ahead during the Seventies. The Government of President Sadat adopted a new policy encouraging the private sector and competition, *"the open-door policy"*, after about twenty years of socialism and nationalization. However, the pace of private sector expansion slowed down during the Eighties, as a reaction to problems caused by the sudden change (e.g. inflation, over encouragement of foreign investment compared to national investment). In 1978 a restructuring program was initiated to reform the fiscal system and liberalize the currency, but actual implementation was slow and limited in scale.

In 1987 the Government adopted a comprehensive economic reform policy to face the economic crisis. The programme included cuts in Government expenditures and subsidies, liberalizing trade and reduction of exchange controls in effort to reduce public deficit, external debts and unnecessary Government subsidies, while preserving the strength of the local currency against other currencies and avoiding extra burdens on citizens. The major Government strategy for doing so rested upon the introduction of a package of monetary policy reforms and more encouragement of the private sector (Hasabou,1994).

Denationalization and privatization, strongly recommended by the World Bank and the IMF, began to be considered as a policy option in the early Nineties. In 1991 privatization was announced as a government policy. It was considered a major complementary step to the Egyptian Economic Reform Programme, announced a few years earlier. The new Law 203/1991 was issued in the same year permitting partial and/or full sale of public sector companies for the first time. This was followed by the announcement of a five-year privatization programme including the annual privatization of at least 25 candidate companies in each of the five years between 1992\93 and 1996\97. The programme was accompanied by a plan for restructuring loss making public enterprises and another for dealing with problems of redundant employees (El Tabaakh, 1997).

## 2.4 Why Privatize?

One of the main reasons for privatization is the low efficiency of public sector enterprises[1] reflected in their failure to achieve most of their goals. In spite of all the investments and efforts to maintain and improve public sector performance, many studies have shown that the performance of SOEs, whether in developed or developing countries, is far less than satisfactory[2]. In most cases SOEs turned from being ambitious projects into a drain on national investments. Very few of the initial objectives of SOEs were actually attained. Instead, SOEs have in most cases become a burden on the economy eating up scarce resources and hindering growth. The low efficiency of SOEs, especially when compared to similar enterprises in the private sector, has usually resulted in large deficits that were financed in ways negatively affecting the economy.

El-Naggar (1989) shows that subsidies and uneconomic credit facilities have backed the SOE system for years, diverting away scarce funds from both growth-enhancing public-spending projects such as education and more economic private sector activities which produce better quality at lower costs. The negative effects on the financial and banking systems and on the economy as a whole are damaging and, in many cases, irreversible, especially in low-income countries (Berg, 1987).

[1]Public sector enterprises or State-Owned Enterprises (SOEs) both refer to public sector entities that have separate legal personalities that have accounts expenses and revenues and where the government acts as a manufacturer or trader of goods or services.

Hemming (1988) emphasizes the importance of regulating market forces in the private sector. The product market guides prices and output, while the capital market constrains costs. If a private firm is not good enough, it will not sell its products and therefore it will not make profits. Loss making firms will be liquidated or taken over. Investments will automatically be directed to more profitable, more productive and more efficient activities.

A number of studies show that successful privatization of a few SOEs would greatly improve the performance of both privatized and unprivatized enterprises. Galal et al (1995) analyzes the experiences of twelve different countries with privatization. It provides evidence of the many benefits of successful privatization including reduced state sector deficits, increased investment in privatized enterprises and better quality production for lower prices. This would be achieved as a result of increased competition, improved efficiency, lower deficits and better allocation of resources.

Moreover, there is some empirical evidence that privatization enhances performance not only in developed countries but also in developing countries. In a World Bank study Galal et al (1995) assessed the welfare gains and losses resulting from the privatization of twelve companies operating mostly in non-competitive markets in four different countries (Chile, Malaysia, Mexico and the United Kingdom). They found that welfare gains were achieved in eleven of the twelve cases and that there were no cases in which workers showed an overall loss from privatization. Although the results of that study cannot be generalized because, as the authors pointed out, the sample was small and unrepresentative of the universe of privatized companies, the results are indicative (Galal et al, 1994).

Megginson, Nash and Van Randenborch (1994) reached similar conclusions. Their empirical study covered sixty-one firms in eighteen countries and thirty-two industries comparing their pre-and post-privatization financial and operating performance during the period from 1961 to 1990. The authors reported strong evidence that after privatization the sample firms became more profitable, increased their real sales and investment spending and improved their operating efficiency. The companies also significantly reduced their debt levels, increased dividend payment and increased employment rates. However only three to twelve of these firm, depending on the financial and operating performance measure, had headquarters in developing[1] countries, which makes this study more relevant to developed countries.

Another study (Boubarki et al, 1998), more indicative of developing countries, studied seventy-nine newly privatized companies in a wide range of geographic dispersion and different levels of country development during the period 1982 to 1992. The authors' objective was to determine whether privatization is truly desirable in developing countries and whether the performance of privatized firms lived up to the expectations of governments and development agencies. The study aimed to find out whether privatization increased the firms' efficiency, profitability and output. It also assessed its effect on employment, capital structures and dividend policies in these firms. The study examined the relevant performance indicators of the sample firms for three years before divestiture and three years after divestiture. The results showed significant improvement in profitability increases in operating efficiency, capital investment spending, output and employment, a decline in leverage and an increase in dividends. The study's conclusion was that privatization brings with it private owners who place greater emphasis on profit goals and carry out new investments that increase output and employment, which increases efficiency and hence profitability.

Kent (1987) summarizes the rationale for privatization in four simple ideas:

- Those who want goods provided by the government should pay the full costs of doing so. This could be done through user fee schemes that make service recipients pay for the service rather than transfer the cost to taxpayers.
- Production in the private sector is likely to be more efficient and less costly than government provision, due to competition. Competition ensures higher quality, lower prices and introduction of new technology.
- Consumers are likely to be more satisfied by having a variety of alternative service providers from whom they could choose. If they are not satisfied with the price or quality of one provider they can turn to another provider. A market with many service providers is structured to accommodate to the varying preferences and tastes of the consumers.

[1]The terms developed and developing are loosely used and include wide variations under each category. One broad definition of developed countries is that they are members of the OECD. The remaining "developing" countries would then include a wide range of middle and low income countries. For more precise definitions see World Development Report.

- Unlocking the innovative genius of the entrepreneur will provide new service delivery systems and technologies. Entrepreneurs will be given the chance to find new ways of better meeting consumer demand at lower costs.

## 2.5 Opponents of Privatization

While many economists encourage privatization stating that the private sector is usually more efficient than the public sector and that competition improves quality, there are some views and pressures that are totally against privatization. In many countries trade unions representing public sector workers oppose privatization and sometimes the opposition is more widespread (e.g. people's strike against privatization in Puerto Rico[1]).

Some social scientists and commentators also fear the social negative effects caused by privatization. An example of these views are those expressed by Martin (1988) in UNCTAD's session about social aspects of privatization and competition and regulation of privatized monopolies. Martin (1998) states that *"the neo-liberal model is failing to deliver long-term, either economically or socially, for the vast majority of people."* According to him, the social safety nets proposed by the World Bank are insufficient and requires *"fundamental redesign"*. Privatization should contribute to the achievement of full employment and poverty reduction and not exclude large numbers of people and provide only for the short-term victims of change. He also mentions that most countries' experiences confirm that privatization has created more problems than it has tackled, although this is seldom openly acknowledged. He continues to certify that competition should not be introduced for the sake of competition and that under certain circumstances monopolies may be justified. Examples of these cases are when cost efficiency outweighs the benefits of competition or where certain profitable parts of the industry subsidize other loss-making segments.

Another author who opposes privatization is Edward Herman (Herman, 1997 and Herman et al, 1997). He holds that it is not necessarily true that efficiency improves when firms *"strive for profits"* under competitive conditions. It is his view

[1] Appeared in Puerto Rican Newsletter on July 7th, 1998. It was also reported by People's Weekly World, July, 1997, a publication of the Communist Party in USA.

that competition creates its own forms of waste, such as advertising and the inefficiencies of having small firms instead of one large public agency. He also thinks that competition *"inflicts social damage such as plant closings and environmental destruction."* Global privatization from his point of view is *"a serious setback for democracy"*. He thinks that it is only pushed by *"an elite alliance"* against the will of the majority of people with an objective of weakening labour unions, strengthening support for capitalism and diminishing the power of governments to make financial gains. He states that this is against democracy.

He identifies the financial community, *"thriving"* to sell stocks as the main force behind privatization. He mentions that with an annual average of $ 100 billion worth of privatizations in recent years, an annual average of $3 billion (an average of 3%) goes to bankers as fees. In Britain alone bankers, accountants, brokers and management consultants earned $1.1 billion in fees in the period 1981 to 1988. This kind of money has increased the financial community's support for privatization.

According to Herman another force behind privatization is the companies eager to buy up public assets for use or resale, at the comparatively low prices governments offer. He also mentions that corruption shouldn't be overlooked in many of these cases.

Herman states that privatization shouldn't be a way of meeting budget shortfalls and financing infrastructure improvements. This could be done by raising taxes, on those who can afford to pay or debt write-offs in the case of Third World nations. These options are not sought due to business and bank interests and pressure from the IMF.

Further, Herman thinks that the main way that privatization increases efficiency is cutting down on labour costs, in many cases for political causes, leaving the problems of labour unsolved. He states that if any government is willing to increase efficiency of public units without privatization it would be able to. His proof is the successful restructuring efforts governments perform in the preparations for privatization.

In many cases opposition to privatization has resulted in lawsuits against the government (Eggers and Moore, 1997). In the United States some of those lawsuits are still in progress and a few of them actually succeeded in restricting privatization projects that replace public employees. In California the courts have long held that the state constitution prevents the state government from contracting out any job that can be performed by civil servants. Colorado's state constitution provides similar protection stimulating that no function performed by a state employee can be contracted out to the private sector. In Hawaii, the state supreme court held (in 1997) that the state constitution protects civil service positions unless state legislation specifically exempts a position from protection. It is the authors' view that these cases and others highlight the need for state legislation to clarify the issue and to grant local governments the authority to use privatization. The main objective of the government should be how to provide the public with the best service at the lowest cost. This could be done sometimes by privatizing and sometimes not, but governments should have the right to choose. They also ascertain that although public employees deserve fair treatment, governments are intended to serve citizens and taxpayers not public employees only.

Henderson (1996) states that opposition to privatization can be neutralized by offering a share of the net gains to employees as stakeholders. In England this was done by turning over 82% of the newly created stock in the National Freight Corporation to current and former employees. It was also done when privatizing local authority owned housing by allowing tenants to buy their units at discounted rates so that the public sector could get rid of the houses it rented at rates so low that in some cases they did not cover the maintenance costs. In 1989, the Mexican Government acted similarly by lending money to the workers' unions to enable them to buy 4.4 per cent of the Telephone Company. Chile's officials also succeeded in privatizing 52 per cent of previously expropriated farmland by selling at below-market prices to farm workers. In Argentina, labour opposition to labour layoffs was neutralized by severance benefits that often exceeded one year's wages.

It is clear from the above that privatization has positive contribution to make especially in certain sectors. The opposition to privatization of many authors is based on concerns about labour redundancy and ideological positions on the gains being made by the new private sector owners at the expense of the employees and customers. These issues are also at the base of the resistance of SOE managers and employees to privatization.

## 2.6 Recent Studies about Pr
## Public Sector

One of the first papers about privatization in Egypt was by Seddik Afify (1991). The paper included justifications for SOEs, a description of their present status then and why privatization is necessary at this stage. The study continued to describe different possible methods that could be adopted by the Egyptian Government and concluded by identifying several problems that could occur and how they could be faced (Afify, 1991).

Moore (1998) reviewed recent developments in the Egyptian economy up to 1997 with a very optimistic view of the future. The author states that Egypt's achievements over the first six years of the 1990s are "*unequivocally impressive.*" He states that in mid-1997 the reform measures began to bear fruits, GDP was rising, inflation was subdued, the budget deficit was under control, foreign exchange reserves were expanding and the Egyptian pound was holding value. He acknowledges that although there is potential resistance to reform and some problems hindering privatization, he thinks that the Egyptian politicians will easily overcome them.

Although Galal (1995) agrees with Moore that there has been improvement in the Egyptian economy as a result of reforms, he still sees that there are some constraints. He states that macroeconomic reform succeeded in aligning the exchange and interest rates closer to market value, increased competition, reduced inflation and cut the fiscal deficit but institutional reforms lag far behind. According to his survey, firms see policy uncertainty as the most binding constraint. He also mentions excessive regulation and weak enforcement of contracts. He suggests that payoff from institutional reform can be maximized by reducing policy uncertainty followed by reforms to rationalize tax administration and that in many cases more competition and privatization are the best solutions. He concludes that further macroeconomic reforms are needed to correct accumulated problems from previous decades and that this will only happen if institutional reforms were more successful. Without deregulating the economy further, enhancing the enforcement of contracts and strengthening Egypt's credible commitment to reform, macroeconomic reforms alone are not likely to bring about substantial long-term economic growth. This study points out the importance of restructuring and reform at the institutional level which encouraged the researcher to devote a chapter to study this issue.

Another issue that is relevant to restructuring is labour management and reduction of overstaffing. This was covered by Ragaui Assaad in a paper analyzing compensation programs for redundant workers in the Egyptian public sector (Assaad, 1989). The objectives of the paper were to estimate the rents that public enterprise workers would lose if they left their jobs and to stimulate various voluntary severance schemes to determine their relative efficiency in achieving the exit rate targets at the lowest fiscal cost. The author produced several models that could be used. The researcher agrees with Assaad that labour issues and how to deal with redundancy are amongst the most important obstacles to public sector reform in Egypt. A chapter in this thesis is devoted to study a few aspects of this problem.

Among publications most related to this study is a paper by El-Ghatit (1998) discussing perceptions and expectations of managers and employees in a hotel that was transferred to private management. The objective of the study was to investigate how superiors and subordinates perceived the change to private sector management in a public sector hotel concerning issues like recruitment, authority delegation problems and employee expectations. The paper is based on one detailed case study that illustrates change issues, resistance to change and attitudes of the workforce. The study concludes that follow up and problem identification were very weak under previous management. As for the problems facing the new management the most frequently mentioned ones by managers were renovation and the resistance of staff to change, while employees emphasized ambiguity. Solving these problems according to the author would simultaneously solve other related problems. He finalizes his paper by suggesting several solutions to the different problems. Increasing employee participation is the first step followed by facilitation of the change process through effective communication. Furthermore the staff should also be given a chance to complain.

Management perceptions and attitudes towards privatization were also studied by El-Demellawy (1993). The study focused on the mining, porcelain and chemical industries and concluded that economic regulation of SOEs is in need of reform. Removing regulations concerning composition and marketing of output, giving SOEs more liberty in dealing with labour and establishing a more efficient performance evaluation mechanism were some of the recommended reforms. On the whole, the study is in favour of a more liberalized economy. It states that increasing competition in the Egyptian environment is the most potent way of changing the roles of the public and private sectors. The researcher also thinks that the option of divestiture should be given serious consideration as a means of reducing the financial burden on the public sector and improving the operating efficiency of SOEs. She thinks that although privatization is highly beneficial it raises three major problems. First, political risks exist and these can be faced by emphasizing to the public the advantages that will be derived from privatization. Second are the institutional changes and reforms required which can be faced by establishing privatization offices. Finally, the labour problem which the Government must deal with.

Dahroug (1995) investigates administrative deficiencies in the structure of management of SOEs in Egypt, operational deficiencies and administrative obstacles in the implementation of the privatization programme and finally labour and labour union deficiencies facing the implementation process. It concludes that deficiency in implementation is mostly due to the novelty of the situation and not giving management enough time to become familiar with the relevant concepts and requirements. The author also suggests that managers are not sufficiently motivated by privatization, because they do not expect any personal gains from it.

Hassouna from the Public Enterprise Office published a recent study about the stages of development of privatization in the Egyptian economy (Hassouna, 1997). The study described the economic context for privatization including reform measures and recent legislation. It then described the Egyptian privatization programme including criteria for choosing the different companies from a practical point of view. The study identifies some success factors that have to be taken into consideration in designing privatization programmes. Firstly, transparency and availability of information have to be guaranteed. Next is development of the management capabilities of the stock market. The author then ascertains the importance of communicating the objectives of privatization and widening the base of private ownership to people. Valuation procedures should be reviewed and caution should be experienced in selling to foreign investors. Getting rid of unutilized public assets is a priority. Also the public sector should be prohibited from any new investments. Performing restructuring alongside privatization with an eye on the social effects of unemployment and applying early retirement programmes to solve the problems that rise. Finally learning from previous lessons and taking action e.g. canceling direct sales to Employee Shareholders' Association (ESA), improving marketing, finishing off registration of public land and studying the experiences of other countries.

One of the most significant studies written about privatization in Egypt is Khatab (1998)[1]. It discusses the political, legal and implementation constraints on privatization and the solutions the Government adopted to face these problems. It shows how political opposition from state executive authorities was neutralized by making heads of these authorities participate in Ministerial Committees, seminars and workshops organized to set forth privatization policies in various Government sectors. It also shows how opposing media writers were dealt with by daily meetings with the Minister of PE to provide them with accurate information and by establishing the "Cairo Center for Economic Information" in cooperation with the IMF to provide information about privatization and how these efforts affected public opinion favourably. Opposition inside the legislative body was faced by direct contact with members of the Assembly, creating a dialogue around the main issues relating to privatization and answering their inquiries through "Management Information Systems" and "Decision Support Systems" that were established for that purpose. Also support was given to the Defense Bureau in lawsuits initiated by some opposing members claiming that privatization was unconstitutional. The Supreme Constitution Court finalized this by deciding privatization was constitutional. Legal constraints prohibiting sale of SOEs were faced by issuing Law 203/1991 permitting sale of SOEs coupled with Law 95/1992 regulating the establishment and regulations of investment funds, capital markets, ESAs and establishment and management of brokerage firms. Solutions related to the social constraints included negotiations with labour unions, special privileges for workers adversely affected or made redundant, allowing selling majority of the companies to ESAs and implementing optional early retirement programmes trying to solve most of these problems before privatization takes place. Constraints related to the wide variance in valuation of companies were faced by allowing no individual official to take a decision on his own, rather a committee of at least 7 institutions does this, with a condition that the decision is taken by consensus.

[1]Dr. Mokhtar Khatab was later appointed as the Minister of the Business Public Sector in Egypt

The Egyptian experience overcame scarcity of funds by accepting grants from other countries. Finally, using other methods of sale faced the downfall in the stock market. The study claims that the Egyptian experience succeeded in dealing with the challenges faced.

## 2.7 Management of Change and Privatization

In essence, privatization is a major strategic change in the life span of any corporation. No study of privatization could avoid some consideration of the process of change and how it can be made easier or more fruitful.

Nadler and Tushman developed a useful model to understand how organizations operate (Nadler et al 1977, 1979). The model shows the importance of the management role and how a change in environment or strategy changes the outputs of an organization. The authors used a systems approach to create a practical model that could be applied in different organizations. According to them any organization consists of a group of inputs, the environment, which provides constraints, demands and opportunities, different resources, past history of the establishment and most important the organization strategy. These interact in the transformation phase through the tasks of the organization, individuals, organizational arrangements and informal organization to produce the outputs. The outputs consist of the goal achievement, individual performance and behaviour, resource utilization and hence organization performance. · The study states that the relationship among the components is the basic dynamic of the model and concludes that organizations will be most effective when their major components are congruent with each other. The model shows that individuals, tasks, strategies and environment differ to a great extent from one organization to the other and that any change in any of the components of the input or transformation phases will definitely affect the outputs. This is why different changes would affect and be affected by individual performance whether at the employee or management levels. One could deduce from this study that changes to a more competitive environment and a major change in the strategy of an organization as that resulting from privatization would definitely affect the organization, its output and its individuals.

Among the most important factors influencing strategic change is the role of corporate culture. '*Change the culture and the majority of current organizational problems will be solved*' has become, Wilson (1992) asserts, something of a recurring theme from many students of management, theorists and consultants alike. To assure success in any change one has to place people first (Peters et al, 1982). This means that the attitudes and behaviour of people in the corporation will make or break the success of a change endeavor such as privatization.

Wilson (1992) draws attention to the other factors making success or failure. People are important but policies, structure and products also are. Confirming this, Denison (1984, 1990) found that success was related to decentralized, participative decision-making processes, especially when they are a consistent aspect of organizational culture.

Isabella (1990) argues that to understand corporate change fully one requires more than just analyzing the sequence of processes. Individual cognition and interpretation are the key to understanding change. Isabella (1990) studied forty managers in firms undergoing substantial changes both internally and externally. She searched managers' narrative for themes or similarities. She identified four key stages of interpretation (adapted from Isabella 1990: 7-41):

1. Anticipation. Rumors and news present a puzzle to the individual as he puts pieces of information together. Consequently, different pictures of emerging change could emerge as a result of different ways of connecting pieces together.
2. Confirmation. Here, anticipation is confirmed mixed with little objective reality. This guides future action.
3. Culmination. In this stage, the individual will amend prior interpretations of events and reconstructs what has happened. This process involves individuals looking for clues to explain what is happening.
4. Aftermath. This is the final stage during which events, i.e. changes are tested and subjected to experimentation.

This approach, presented by Isabella (1990), anchors the corporate culture into a personalization. 'What will the change mean for me?' is a very important influencing factor in shaping reactions of the individual. One would expect that managers of a firm facing privatization would recurrently ask: What is in it for me? Thus this should be taken into consideration when assessing the Egyptian experience of privatization. This motivated the researcher to perform a study more focused on managers' views.

This interpretative approach to culture has been, nevertheless, challenged. Hofstede (1990) indicates that the interpretation of individuals are themselves located in a wider context: from individual firm to business sector; from business sector to overall national economic context. The relative impact of context thus becomes an important factor in shaping interpretation of any situation such as impending privatization. The impact of the surrounding environment should be taken into consideration when assessing privatization endeavors.

Di Maggio and Powel (1983) postulate that one should not assume that the study of change should be centered on a single organization. The extent to which changes conform to established norms or patterns in the environment will, in their view, determine greatly whether the change will be hindered or facilitated and how it will be evaluated in the future. Privatization projects could benefit a great deal from this understanding. Grinyer and Spender (1979) provided empirical evidence to support this view. Also, Greenwood and Hinting (1988) argue that organizations develop archetypes, which embody where they are now and where they want to be in the future.

Assessing the change dimension in the British experience of privatization, Wilson (1992) states that whilst the wider socio-economic context was being steered in particular directions (particularly following the election of the Conservative Government in 1979) managers had to translate, cope with and adapt to the changing conditions privatization brought about. " *The model thus becomes change within change, rather than the management of change per se*." (Wilson, 1992). Egyptian public sector managers also face a similar situation in the context of the privatization programme in Egypt. Assessment of their attitudes and views in this study provides insights into the manner in which they are dealing with this change and the possible obstacles to privatization if managers find it difficult to change.

Wilson offered a very useful categorization of the contemporary approaches to organizational change. He divided these approaches to planned versus emergent change with emphasis on the process of change versus the implementation of change alternatively. Firstly, change can be planned by managers, but requires analyzing over time. In this case the desired change can be determined in advance and hence other people need to be convinced of the utility of the change and the managerial task becomes one of convincing organization members to welcome the change (see Plant, 1987, Quinn 1980). The second case is when change is articulated in advance, but the emphasis of management is implementation and here the desired change should be determined to specify the driving and restraining forces to facilitate implementation (see Lewin, 1951). The third approach sees organizational change as an emergent phenomenon resulting from interaction of history, economics, politics and business sector characteristics (Hickson, 1986). The fourth approach is "*contextualism*" where implementation is a function of surrounding context as well as internal forces (see Whipp and Pettigrew, 1991). Changes caused by privatization could best be described as planned changes that need management's emphasis on implementation and reducing resistance to change.

According to Lewin's[1] model (1951), the first procedure in any process of change should be to "*unfreeze*" the current pattern of behaviour in the organization, "*move*" to the intended level of response and finally "*refreeze*" it by stabilizing or institutionalizing change. "*Unfreezing*" is an essential step in controlling resistance to change. It could be simply described as "*unblocking*" the present system. If change was restricted to the individual level "*unfreezing*" might involve selectively promoting or terminating employees. If the intended change was more structural or involved a change in systems, then developing highly experimental training programmes such as matrix management, is a must. Finally, if change was more comprehensive to include the organizational climate and how decisions are made, providing data feedback on how employees feel about practices is essential. The author states that to promote change the driving and restraining forces should be identified and selectively removed. Ideally, an increase in the driving forces will create a greater degree of change while extra pressure or restraining forces would hold change back. The movement stage continues until equilibrium between these forces is maintained.

In agreement with Lewin, Plant's study (1987), supported the importance of training managers to recognize driving and restraining forces and to take action to manage the balance in the desired direction. According to his model the process of change constitutes collecting data, analyzing it, creating a vision about the desired

[1]Lewin was one of the first analysts to write about psychology of organizations.

situation, taking action and finally implementing the change. Managers *should* test what powers they have in order to have influence over the numerous organizational forces or *should* adopt certain interpersonal tactics depending on the situation contingencies. According to the author the most dominant managerial task in the process of change is persuading individuals to accept and support the change. This view encouraged the researcher to study the degree of acceptance of privatization to assess whether it is a *restraining* or *driving* force.

Bechard and Harris (1977) also emphasized the importance of *"the transition"* or *"the movement"* stage (according to Lewin, 1951). They described the process of change in an organization as a transition process in which a certain organization moves from a certain current state to a desired future state. This could very well apply to the transfer of companies from the public to the private sector. Effective management involves developing an understanding of the current state, developing a clear image of a future desired state and moving the organization to it without undue cost to the organization or the organizational members. The question is therefore how to manage the way in which the change is implemented so as to maximize the chances that the change will be effective. The authors ascertain that the way a change is implemented can influence the effectiveness of the transition as much as the content of that change. In their study they discuss developing and employing transition structures such as task forces, pilot projects, experimental unit to manage the transition period. This should be taken into consideration when companies are transferred to private hands.

Based on his empirical work in public and private sector companies, Pettigrew (1985, 1990) states that theoretically sound and practically useful research on change should involve the continuous interaction between ideas about the *"context"* of change, the *"process"* of change and the *"content"* of change. He asserts that implementation cannot be separated from policy formulation and that change is a *complex, messy* process inseparable from its intra-organizational and broader contexts. According to him consequential and complex strategic change decisions tend to reveal more of the nature of unprogrammed and emergent organizational activities. In his studies, organizational change can only be understood in the context of large blocks of time.

Nadler (1993) specifies three basic problems that are inborn in change and that lead to general implications for the management of change. For each of these implications he suggests action plans. The three problems are resistance to change, organizational control and competition for power. The implication of the resistance problem is the need to motivate changes in behavior of individuals which involves overcoming the natural resistance to change and getting individuals to behave in ways consistent with both the short-term goals and long-term organizational strategy. The action plan the author proposes is identifying and surfacing dissatisfaction, getting the employees to participate in change, building in rewards for desired behaviour and giving the organization time and opportunity to disengage from the present state. The implication of the control problem is the need for organizational arrangements designed and used to ensure that control is maintained during and after the transition period. The author develops a useful action plan to do this. According to the plan the first step is development and communication of a clear image of what the future should be. Next is the use of multiple and consistent leverage points. Finally a number of organizational arrangements for the transition are required. These arrangements include appointing a transition manager, providing resources for change, preparing a transition plan and creating transition management structures. The implication of the power problem is the need to ensure that the power centers support the change. The author suggests ensuring and developing the support of key power groups, using leader behaviour to generate energy support of the change using symbols and language to create energy and building in stability. These action plans would certainly be of benefit to privatized companies.

Resistance to change is one of the major problems any change including privatization is likely to face. Zaltman and Duncan (1977) stated that any individual faced with change may be resistant for a variety of reasons. People need a certain degree of stability and change presents unknowns which cause anxiety, insecurity and reduces one's sense of autonomy and self control. Furthermore, people need to find new ways of managing their own environments to replace typical patterns they had developed to cope with previous situations and which are no longer valid. Also, individuals who have power in a certain situation might resist change because it might threaten their power. In addition, some individuals might resist change for ideological reasons. The authors conclude that whatever the source, individual resistance to change must be overcome for implementation of change to be successful. This leads the researcher to realize the importance of assessing managers' attitudes to privatization to examine the extent and reasons of their resistance to privatization and how such resistance could be reduced.

Pugh (1993) gives an important recipe to manage change effectively. He states that there are four rules to bear in mind to understand organizational change. First that organizations are *"organisms"* that can be taken apart and reassembled. Second every reaction to change should be understood in terms of how it affects the ways of working, number of jobs, career prospects and power, status and prestige of the group. Next he states that all members of an organization operate simultaneously in the rational, occupational and political systems. Finally he certifies that organization members who are more successful in their tasks are most likely to accept change better. Pugh mentions six rules for managing change effectively. These rules are establishing the need for change, thinking THROUGH change not merely of it, initiating change through informal discussion to get feedback, positively encouraging those concerned to give their objections, be prepared to change oneself and finally monitor the change and reinforce it (pp. 109-112). These rules ought to be taken into consideration in the process of privatization.

Among the studies that emphasize the role of management in organizational change is that written by Kanter in 1983. She states that firms should adopt decentralized, lean structures and should create organizational cultures which allow organization members to become *"fanatical adherents"* of the objectives and values of the organization. The management of change as such becomes a managerial task where the manager is the *"change master"*. This makes it essential for the manager to be multi-skilled, interpersonally expert, psychologically fluent and constantly able to plan change. Thorne (1991) fully agrees with this view. He notes that change could be planned and that managers in the context of change should become -if they are not already- *"masters of change"*. He states that people responsible for the strategic direction of their organization should definitely have a *"strategy of change"*. Applied to privatization this makes managers the key players in the process and further confirms the importance of studying their views and attitudes.

Another study that shows the importance of managers' role in implementing change was Flushing and Krueger (1995). The study examined the process of transforming Russian SOEs into the private sector. The examination covered ownership states, governance structure and survival strategies relying on data in 34 former state owned enterprises in the period 1994 and 1995. The study was mainly based on interviews with managers in the different SOEs. The main finding was that the former SOEs have become more aggressive and sophisticated and rapidly implementing long-term competitive strategies after privatization. Managers' enthusiasm in implementing and conducting the transition strategies made privatization more effective and resulted in better governance structures which accordingly made survival chances much greater. The study shows the importance of managers' conviction and enthusiasm in the process of implementing privatization. This motivated the researcher to find supporting evidence and information related to the degree of acceptance and desirability of privatization amongst managers in Egyptian SOEs.

Clark and Soulsby (1995), in their comprehensive study on transforming former SOEs in the Czeh Republic, found that the values, motives and actions of the key enterprise managers are essential factors in explaining both the process of transformation and the role of institutional factors in that process. According to them the key players in institutional change and organizational transformation are the senior and middle managers whose "*values, levels of knowledge and experience, accepted practices and competence are important factors in explaining the process of organizational change.*" Senior and middle managers manage the technical and organizational pressure of change but their actions are confined by their convictions, beliefs, knowledge and experiences. This underlines the importance of identifying and analyzing the attitudes of enterprise senior and middle managers in the Egyptian privatization programme. This study is indeed focused on the study of those attitudes and views, which would presumably reflect their values and motives and could be expressed in their actions.

Dobni et al (1996) draw attention to the important role of managers in making the transition to privatization more smooth. In their telling paper "Navigating the Toot to Privatization" they emphasize that "*the transition from a publicly funded to a self-sustaining operation requires fundamental organizational change ... Management must revise the company's mission statement, statement of corporate values and statement of goals and objectives.*" The corporate culture has to change to one that is commercial, entrepreneurial and customer driven. It is the manager's responsibility to achieve this. From the marketing point of view, all marketing techniques of the private sector must be adapted and adopted. Management should establish a basic philosophy that outlines the parameters or limits within which revenue generation will be followed and the proportions in which costs will be shared across user groups. *"Relationship marketing"* may require the company to be flexible on rates, provide incentives where services improvements are required or share other risks as necessary.

Gerry Johnson et al (2000) also ascertained the importance of managers' role in the micro-level aspects of the macro level changes related to privatization. They put forward several propositions to explain how managers and key players in organizations deal with and influence changes from public to private ownership. They proposed that the beginnings of privatization in an institution would have residues of public sector norms and rules affecting individual's actions. This agreed with views of Whitely and Czaban (1998) who found that privatization in itself does not result in the automatic adoption of private sector norms. Their second proposition was that after some time of privatization there would be two types of behaviour that coexist, one influenced by public sector and the other by the private sector. They also found out that the adoption of a private sector template will happen through *"a process of progressive but recursive experimentation."* Finally, they proposed that there would be differences in the degree of adopting rules of private sector characteristics. All these findings ascertain that managers' adoption of private sector norms is not automatic and that they will both affect and be affected by privatization. Johnson et al (2000) concluded that managers would have differing levels of acceptance, differing degrees of experimentation and differing paces of changes throughout processes of privatization. This has motivated the researcher to assess the degree of acceptance of privatization in the Egyptian SOEs.

One of the interesting studies about middle management was a study by Dopson and Stewart (1993) on how middle management survives quickly changing organizations in a rapidly altering environment. The study states that there are two main outlooks for the situation of middle managers, one that is very gloomy and another that is quite optimistic. The main reason for the gloomy view (Dickson, 1977; Torrington et al 1982; Schlesinger et al, 1984; Kanter 1986 and Goffee et al, 1986) is that middle management is usually in the middle of a long hierarchy and that in many cases they are bypassed. Another reason is having to work in the middle of many conflicts and views. Losing their technical experience gradually, career disillusionment and low prospects of promotion are other worries middle management have to bear.

Dopson and Stewart (1993) contradict these views holding a more optimistic view. They agree with many authors (Kanter 1982, Polakoff, 1987, Nonaka, 1988, Buchman et al, 1988 and Weiss, 1988) that information technology has led to reshaping middle management rather than its decline and that the new market conditions have created a need for speedy information, which allows middle management to create and implement concrete immediate solutions for problems that arise. They also found that most of the middle managers they interviewed in both the public and private sectors were positive about the changes and the ways in which they had affected their jobs. Researchers in both groups agree that there is a definite need for more empirical studies in the area of middle management and how they perceive change. This is one of the main reasons middle managers were chosen as a main group of respondents in this current research.

## 2.8 Researcher Comments on Literature Review

The review of previous work on privatization in this chapter has unequivocally shown that there are major gains to be attained from privatization and that these gains have tempted an increasing number of nations over the past twenty years to adopt privatization as a strategic policy option. Yet, it is also evident that the implementation of privatization is not an easy task. There are many problems to be faced and many obstacles to be overcome. Among the most important issues and problems emphasized in the literature are: choice and valuation of companies to be privatized; choice of the appropriate method of privatization; adequacy of the legal framework governing privatization; unemployment caused by privatization; and varying degrees of resistance to privatization from different groups including managers of companies to be privatized.

The literature review also revealed the importance of the management role in managing changes resulting from privatization. Managers who are the *'masters of change'* according to Thorne (1991) have a role of ultimate importance in any process of institutional change and even more in the case of privatization (Clark and Soulsby,1995, Whitely and Czaban, 1998 and Johnson, 2000). Their acceptance and enthusiasm have direct effect on the smooth implementation of the new policies

(Kruger, 1995 and Dobni et al, 1996). Indeed, the role and influence of managers are critical to the success of any privatization programme, which makes studying their views and attitudes of ultimate importance.

These points stemming from the literature review have enlighted the researcher in dealing with the subject. Firstly, they confirmed the importance of the subject and underlined its significant impact. Secondly, the researcher is well guided in selecting the problems to be studied in this investigation, namely extent of commitment of policy makers to the announced programme, problems regarding the legal framework, restructuring and labour related issues, problems related to the valuation process and managers' attitudes and knowledge.

The literature review has also helped crystallize which methods of research are most suited to the study. The triangulation strategy of empirical investigation is indeed the one that will best serve the objective of the study (see Chapter One and Five).

The literature review has also helped develop a proposed 'good practice' model to be used as a benchmark in assessing the problems of implementation in the Egyptian programme of privatization. It has also become starkly clear why the thorough identification and analysis of managers' views and attitudes should be a major phase of the study.

## 2.9 "Good" Practice of Privatization - A Proposed Model

### 2.9.1 General Views

Dissatisfaction with the performance of SOEs in most countries has not been reflected in the size or speed of the privatization programmes in different countries. Although many Governments have announced optimistic plans for reforming and selling SOEs, their achievement has been slow especially in developing countries. A World Bank policy research report (Galal et al, 1995) states that divestiture efforts in developing countries, other than transition economies, have not exceeded an average of three enterprises per year although most of these Governments own hundreds of firms. SOEs still accounted for an average of around 14 per cent of GDP in most developing economies, in 1995. According to official Government documents the public sector in Egypt owned 629,439 million Egyptian pounds (equivalent to $ 224,800 million, worth of net assets[1] and employed around 1,935,006 workers in the same year (Public Enterprise Office (PEO) internal publications, 1995).

It is clear from the experiences of different countries' that different practices of privatization lead to different degrees of success. Reasons vary from one country to the next. Some countries encounter problems during implementation and others face them at the very beginning. This could be due to the absence of an integrative plan, lack of commitment, strong resistance, or simply because privatization is not desired by those in charge.

Using three objective indicators (SOE financial returns, productivity and savings-investment deficit), Galal (1995) examined SOE reform results in twelve different countries. The objective of the study was to establish a relationship between successes in improving SOE performance and the extent to which each country used the five components of reform theorists and practitioners widely recommend. These components are divestiture, competition, hard budgets, financial sector reform, and changes in the institutional relationship between SOEs and Governments.

Galal (1995) concludes that the most successful reformers used all five components together as complementary elements of an overall plan. The other less successful countries followed a less comprehensive strategy. Key findings were (Galal et al, 1995):

- *Successful SOE reformers divested more.*
- *Successful SOE reformers introduced more competition and liberalized trade.*
- *Successful SOE reformers hardened SOE budgets: They decreased or eliminated direct and hidden subsidies. They also reviewed the SOE access to credit rules setting new more commercial ones.*
- *Successful SOE reformers reformed the financial sector. They strengthened supervision and regulations, relaxed controls over interest rates and reduced directed credit. They also relaxed entry restrictions and privatized banks.*
- *Both successful and unsuccessful reformers alike tried to improve the incentive structure by changing the relationship between SOE managers and the Government. More autonomy was given to managers, new oversight bodies were introduced and different management contracts were created.*

[1]Not including military production.

Based on these results in the twelve different countries Galal (1995) identifies three conditions that have to exist in a country to be ready for reform: political desirability, political feasibility and credibility.

- Reform is politically desirable when its political benefits outweigh its political costs. This could happen when those who lose from SOE reform are no longer an important part of the leader's support groups or when an economic crisis makes SOEs too costly to keep.
- Reform is politically feasible when the leaders have the ability to gain support from the relevant government entities and the ability to face opposition to reform.
- A government has credibility when the different parties involved believe it will fulfill their promises e.g. investors must believe that the government will not re-nationalize the privatized SOEs, and managers and employees must believe the government will deliver whatever compensation it promises.

Galal et al (1995) shows that only when these three conditions are met, reform efforts succeed. Hence, according to the authors, it is only a waste of effort and money to pursue these efforts without making sure the three conditions are satisfied. Stemming from these results the authors have developed a useful decision tree (figure 2.2) that shows the many choices Governments face during the different stages of reform stressing the importance of the logical order of the different steps while making sure the country is actually *ready* for reform in the first step. Extent of r*eadiness* of a country for privatization according to the authors is mainly a question of abundance of the three conditions of political desirability, feasibility and credibility. The decision tree also shows the importance of terminating the preparation stage before starting to establish privatization programmes.

**Figure 2.2: A Decision Tree for State-Owned Enterprise Reform**



*Source: Galal, Ahmed, Mary Shirley and Philip Keefer, Bureaucrats in Business: the Economies and Politics of Government Ownership, published for the World Bank, Oxford University Press, New York, USA, September 1995.*

Although the researcher agrees with the above analysis it is the researcher's view that the three conditions of desirability, feasibility and credibility have to be abundant not only at the policy making level but also at the implementation level. If not, smooth implementation would be seriously hindered. This gave impetus to this researcher to study whether desirability, feasibility and credibility are present in the Egyptian setting, at both the policy making and implementation levels, and thus whether Egypt is actually ready for privatization.

Further, the decision tree does not mention the role of managers' attitudes in the reform process. It completely neglects their views, motives and extent of agreement with the policy of privatization in general and these steps in particular. The tree concentrates on whether the country is actually ready for privatization and on different reform and restructuring measures while completely overlooking the role of the managers and whether their attitudes and views influence the situation. Changing managers' relationship with the Government and management incentives are discussed later in the book but managers' extent of agreement to different reform measures and resistance are not investigated. Bearing in mind that SOE managers' views and attitudes could be crucial in bringing privatization plans about (see Flushing and Kruegere, 1995, Clark and Soulsby, 1995, Dobni et al, 1996), this current study has focused on investigating their role and attitudes and whether they influence the implementation and how.

In implementing privatization it is also essential to determine whether the Government intends to adopt a top-down approach or a bottom-up approach. Donaldson (1995) states that the best way to implement privatization is entirely dependent on the extent of Government commitment and strength. If commitment is high and the Government is strong enough a top-down approach is easy to implement. He mentions Peru as an example of this approach and reports how it was successful in focusing solely on economic objectives rather than fear of resistance allowing it to accomplish very successful sales. On the other hand, if the government's commitment exceeds its strength, or if resistance is strong, a need emerges to start at the bureaucratic levels and persuade employees throughout the organizations of the new changes in a bottom-up approach. This was adopted successfully with the help of international institutions such as the International Finance Corporation in Russia (Donaldson, 1995).

### 2.9.2 A Proposed Model

As evident from the previous sections of this chapter, privatization is a complex process requiring changes of policies, laws, implementation and information campaigns at a number of levels and that could also be faced with resistance at different stages. Based on the literature survey and interviews with high ranking executives directing the privatization programme in Egypt the researcher has conceptualized a model for what can be considered "good practice" of privatization (Figure 2.3). The steps recommended in the model are judged by the researcher as essential for smooth and successful privatization. The model is intended as a guide for the researcher to assess privatization policies and practices in Egypt. The steps are explained below.

**Figure 2.3: Privatization Steps: A "Good" Practice Model**

## Policy-making Level

**(Largely a question of political commitment and effective implementation at the policy making level )**

Check whether privatization is actually desirable
Develop a plan for the different stakeholders and resistance groups
Develop and implement a comprehensive programme of macro-reform
Change laws and companies' systems to make them more suitable for the change
Develop a comprehensive plan of privatization
Develop adequate, firm and strict programmes of privatization
Create a structure with clear responsibility and authority for implementing the programme
Define responsibility levels of implementation clearly allowing for adequate accountability
Develop a clear monitoring system with required accountability procedures
Determine different methods of dealing with the management and work force
Develop a comprehensive marketing plan
Develop a mass-media-backing plan

↓

## Implementation Level

**(Mainly a question of effective communication and efficient implementation)**

### *A. Industry Level*

Clarify the programme to all those involved
Establish a communication network to discover and overcome any problem
Develop a restructuring programme for low performing units
Choose privatization candidates
Choose appropriate privatization method for each candidate
Use several valuation methods to reach the most adequate price
Apply the most appropriate pricing mechanism
Prepare feedback for the monitoring system

↓

### B. Enterprise Level

Prepare privatization candidates for privatization by:
-Making sure managers at the different management levels fully understand and have a positive attitude towards privatization
-Clarifying the situation for the work force and specifying their alternatives making sure they accept the new policy
-Restructuring the unit if needed
-Clearing the entangled situations related to previous privileges, contracts or obligations
Apply the most appropriate privatization technique for the company
Prepare feedback for the monitoring system

#### 2.9.2.1 Policy-making level (largely a question of political commitment and effective implementation at the policy making level)

At this level the whole process of privatization should be planned and monitored. It also includes necessary preparatory measures that make the environment readier for smooth implementation of privatization. Such measures ensure conditions of desirability; feasibility and credibility (Galal et al, 1995). The following steps are recommended:

- **Check whether privatization is actually desirable**

This condition could be considered the main pre-requisite for privatization. According to one of the World Bank Reports (Galal et al, 1995), reform becomes desirable when its political benefits for leadership outweigh its political costs. This happens when those favouring continuation of SOEs lose power or when the problems of subsidizing SOEs become so costly that reform becomes preferable to their existence. Also, in many cases there is considerable pressure from IMF, World Bank and different international organizations to adopt privatization as a policy. This could either create genuine desirability for privatization or merely force acceptance of privatization as the only alternative.

Evidently, genuine desirability facilitates implementation starting from the highest-ranking officials to the lowest-level employees (Dobni et al, 1996). Acceptance of privatization and adoption of private sector norms is not an automatic result of privatization (Johnson et al, 2000). Programme leaders who do not truly desire privatization would either hinder implementation or fail to convince their subordinates at lower levels of the importance of fulfilling the different privatization plans. The inevitable result would be that privatization programmes fall behind.

- **Develop a plan for the different stakeholders and resistance groups**

Many stakeholders are involved and are possibly affected by implementing privatization. The Government, company executives, employees, workers, prospective investors, opinion leaders and even the public at large, both affect and are affected by privatization, whether directly or indirectly. Most of these stakeholders could turn into resistance groups (see Nadler, 1993, Zaltman and Duncan, 1977 and Lewin 1951), if they were not convinced that privatization was in their interest and truly 'desired' it, especially, that many of them could lose jobs or benefits by the shrinkage of the public sector. This is why a well-prepared plan to deal with each group of stakeholders is necessary in the planning and preparatory phase. It would help increase the desirability of privatization policy and hence facilitate implementation. The privatization policy would only be feasible if most stakeholders and possible resistance groups believe that privatization will benefit them.

At this stage broad lines for the privatization policy marketing plan should be initiated. Opinion leaders should be the first to be addressed by acquainting them with the pros and cons of the system and reasons why it is necessary to pursue it. Long-term advantages at the national level should be made clear to all. The Government policy to face possible job losses should be announced. Increases in prices should be made gradually starting by unnecessary goods. Good communication and marketing of the whole policy in general is essential.

- **Develop and implement a comprehensive programme of macro-reform**

It is of little use to restructure or privatize SOEs in an economy, which has structural economic problems. Getting rid of or restructuring some of the loss-making SOEs would be difficult due to lack of capital and would only create problems of unemployment in such an economy. An integrative approach that considers privatization part of it is necessary. A comprehensive transformation of the economy from a centrally planned system to a free enterprise one is advisable. Prices should be freed from government control. Subsidy systems are to be kept to a minimum. Fiscal policies should be developed to curb inflation and to achieve stability of foreign exchange rates. Productivity should be enhanced. Unemployment should be tackled.

- **Change laws and companies' systems to make them more suitable for the change**

For privatization to succeed, a change in the legal setting of SOEs is needed (especially in socialist-oriented economies). The changes could be related to macro economic measures that direct the economy to a more market-friendly competitive environment, or to enterprise-level changes that allow implementation of privatization e.g. permission of sale of government ownership. Accompanying alterations in laws governing company systems are also essential to create a more appropriate environment for privatization. Laws for the capital market and for the encouragement of private investment should be developed. Labour laws should be compatible with a market economy.

- **Develop a comprehensive plan for privatization**

At this stage a comprehensive plan for privatization is developed. The plan should include Government priorities, how they are going to be met, who would be in charge, authorities and responsibilities, possible (rough) timing, expected and possible problems and ways to tackle them and methods of monitoring the different plans.

At this stage decisions of which SOEs are to be kept, sold or restructured are taken according to Government priorities. Profitability, size, activity, ownership and technology are among many determinates that have to be considered in specifying which SOEs to start with (Afify, 1991).

Governments could choose to start by restructuring loss-making companies and selling profitable ones to attract more investors, or could choose to divest loss-making companies to quickly get rid of their burden. Many variables influence which strategy to be pursued.

Governments should determine their priorities concerning size. In their initial steps programmes could start by selling smaller units to facilitate the selling process and to increase the number of prospective investors. In other countries, where capital and stock markets are fully developed, starting with bigger enterprises could be feasible.

Privatization priorities could also be determined according to enterprise activities. Many of the SOEs operate in activities that naturally suit the private sector or are not of strategic importance. These companies should be privatized first. In Egypt, trade and distribution, tourism and hotels, transport and construction and high technology activities could be among the first candidates to be transferred to private hands. Most of these activities need constant development and could be more successful in private hands.

SOEs that already have a private share in them are also much easier to start with. Also companies the sale of which would correct monopoly positions in the market should have a priority in privatization programmes.

- **Develop an adequate, firm and strict programme of privatization**

After ensuring an appropriate environment for privatization and adopting a comprehensive approach to reform and developing a comprehensive plan for privatization, specific programmes should be developed. To ensure feasibility of these planned programmes, it is essential to make sure of their adequacy prior to implementation; otherwise many problems might arise. This could be achieved through close coordination with a 'privatization-candidate-choosing' committee at the implementation level. Once this has been taken care of, firmness and strictness of the planned programmes add to credibility of the whole policy. If the Government actually implements its plans then stakeholders would feel that:

- the Government knows what it is doing; and
- they will definitely offer what they promise whether to investors, managers or employees.

On the other hand if the Government is not very strict in implementing its plans this attitude would definitely be transferred to the different implementation levels. " It is only talk" would be the attitude in the different levels of implementation resulting in slowness and maybe impossibility of implementation. In addition prospective investors need to feel the seriousness of the Government in order to consider such investments that usually require considerable study, planning and, in many cases, might involve high risks.

- **Create a responsible structure for implementing the programme**

A responsible structure in charge of implementing the programme should be created. Its main responsibility should be carrying out the plan and specific programmes. Any problem encountered in implementation should be reported to the monitoring committee. The structure should include full-time personnel in charge of implementation and part-time representatives of the different parties involved in the process (e.g. managers in holding companies or officials in the stock market) to help in planning and facilitating actual implementation.

- **Define responsibility clearly allowing for adequate accountability**

Defining responsibility clearly is complementary to creating a structure in charge of implementation. It is a pre-requisite for successful implementation and allows for accountability in case plans are not fulfilled.

- **Develop a clear monitoring system with required accountability**

The monitoring system's main responsibility should be ensuring smoothness of implementation. Without efficient monitoring, problems could be left unsolved, thus hindering the whole process.

- **Determine different methods of dealing with the management and work force**

Perhaps one of the biggest problems that could affect the rate of privatization are issues related to the management and work force, especially that privatization might cause loss of positions or jobs. The importance of the role of management in implementing the change is undeniable (see Thorne, 1991, Flushing and Kruegere, 1995, Clark and Soulsby, 1995 and Dobni et al, 1996 ). Different methods of dealing with different levels of the work force include training and retraining, compensation schemes, early retirement incentives, support programmes to help find alternative jobs, schemes to encourage self employment and many other options that will be dealt with in a separate chapter. Developing and implementing appropriate schemes that managers, employees and workers perceive as just will definitely reduce possible resistance of those parties and would increase feasibility of implementing the whole programme of privatization.

- **Develop a comprehensive marketing plan**

A comprehensive marketing plan is needed to prepare for and promote the privatization policy and the different privatization programmes. The plan should be designed at three levels. The first level should deal with promotion efforts of the privatization policy in general developing programmes for the different stakeholders. Another level should be concerned with marketing specific programmes and action plans including the details of the companies to be privatized, different methods of sale and prospective buyers of companies. Finally, marketing plans should be designed for individual SOEs that are to be privatized determining method of sale, prospective buyers, price and a promotion plan.

Taking into account capital markets and the possibility of attracting international capital into the country, marketing efforts should take a wide international perspective to attract both local and international investors.

- **Develop a mass-media-backing plan**

The mass media are the major communication facilities that could be directed to the public in general. Implementing a good campaign would enhance public backing and would decrease chances of public objection and resistance especially to changes that might cause less jobs or higher prices.

### 2.9.2.2 Implementation Level (Mainly a Question of Effective Communication and Efficient Implementation)

Success at this level is crucial. It includes implementation measures that should be taken at the industry level and others that have to be implemented in the different enterprises.

**A. Industry Level**

- **Clarify the programme to all those involved**

One of the main responsibilities of top management at the industry level (more involved in the planning process) is to clarify and justify the programme to executives and managers in the company. Top managers constitute an important link between policy makers at the policy level and parties involved at the implementation level. Their task includes clarifying the government plan, priorities and programmes to all those involved. This could be done through seminars, meetings or published material. Face-to-face communication enhances clarity and helps reduce unanswered questions and hence reduces resistance and increases desirability.

- **Establish a communication network to discover and overcome problems**

Efficient communication is a key factor in the success of the whole process. It is needed to communicate all the expected changes clearly to all those involved. Rumors and false information could cause undue resistance that could decrease feasibility of the process.

Efficient communication is needed at all levels. As a minimum the following should be communicated:

- Government priorities, plans and programmes;
- changes in SOE systems;
- changes in management and management systems;
- changes that would occur due to restructuring or sale, and
- different options for managers, employees and workers.

In designing the communication system it is also important to know what the government approach is. Is it a tough top-down approach of which the main task is informing whoever is in charge of his duties and monitoring for any mistake? Or does it go further to convince those involved with the new policy? In other words is the main objective merely notifying those concerned or is it to obtain consent?

- **Develop a restructuring programme for low performing units**

Loss making and low performing units could be one of the challenging obstacles to privatization. In most cases these companies need substantial restructuring prior to sale. Restructuring could be related to financial aspects, human resources, management systems, physical premises or machinery and equipment used. Costs of restructuring should be compared to benefits of selling after restructuring. Where appropriate, comprehensive restructuring programmes should be developed to increase attractiveness of the Public Enterprise (PE) and hence its selling price. If restructuring costs were expected to be too high selling the SOE as it is and liquidation options should be studied.

The restructuring programme should be prepared at the implementation level where more awareness of company circumstances exists and then reviewed by the Government after comparing benefits of restructuring with costs. The Government should then develop a comprehensive restructuring programme as part of the privatization plan. It should include companies to be restructured, areas needing the reform in each company, expected period and costs and who would be in charge of the restructuring.

Professional specialists, banks, new managers or Government committees could implement the Government restructuring programme. Another option could be contracting out or leasing low performing entities to the private sector for lower prices with the condition of restructuring, as an intermediate step prior to selling. If costs of restructuring were too high low performing or loss-making SOEs should be sold for lower prices or, if still unattractive, liquidated.

- **Choose privatization candidates**

Actual choice of companies to be privatized according to Government priorities comes next. Smaller, non-strategic, profitable SOEs with private shares are generally easier to privatize. However, the selection committee should base its decisions on a case by case basis enlightened by the Government priorities. The choices should then be passed over to the planning committee, which, in case of approval, would convert them into action plans and programmes.

- **Choose appropriate privatization method for each candidate**

There are many methods of privatization (Vuysteke, 1988). Choice of the most appropriate method depends on company, industry and country circumstances. A recommendation should be prepared at the implementation level which is more acquainted with company circumstances, and given to the planning committee at the policy level to study, in order to reach a final decision that is later transformed into implementation programmes.

- **Choose the most appropriate valuation methods to reach the most appropriate price of SOEs offered for sale**

There are many valuation methods for determining the price of SOEs to be offered for sale. Discounted cash flow, capitalization of income stream, excess earning, economic value, comparable sales and price/earning methods are only examples of such methods (Chapter Nine). Several of these methods could be applied separately or combined to reach an average that is nearest to the true value of the company.

Fear of inaccurate valuation represents one of the major obstacles to privatization in many cases. It could reduce desirability to reach a valuation decision and later to implement that decision. This might cause undue slowness in the valuation process of different companies and hence in implementing privatization in general.

- **Apply the most appropriate pricing mechanism in case of public offering**

The pricing mechanism and the price are clearly important to ensure completion of the sale and adequate proceeds for the government. The two most common pricing mechanisms for public offering are the fixed price and the tender price methods. In the case of private sales, whether of shares or assets, auctions and competitive methods are most commonly used (Vuysteke, 1988). Details of valuation methods and pricing mechanisms are included in Chapter Nine.

- **Prepare feedback for the monitoring system**

Periodic monitoring of the programmes at the industry level is needed to help determine what has actually been covered by the programme and to discover any problems in implementation. The outcome of this step could be periodic reports comparing programmes with implementation at the industry level.

**B. Enterprise Level**

Enterprises to be sold are the focus of the privatization programme. It is of utmost importance that programmes are implemented according to plan and any obstacles are detected and dealt with effectively. Executives and managers play the most important role at this level (see Gerry et al, 2000). Success of the whole system is dependent on how far they actually implement privatization decisions made at higher levels. Their true desirability of privatization will be directly reflected on actual implementation and hence feasibility of the different programmes. The plans and programmes will either be materialized into numbers of companies being actually privatized or remain to be rescheduled in future plans.

- **Prepare privatization candidates for privatization**

Preparing privatization candidates for sale requires:

- Making sure managers at different levels fully understand and have a positive attitude towards privatization: Support of managers is essential for quick and efficient implementation of privatization. Not only are they in charge of implementing the new policy but they are also the main communication link between higher policy levels and the work force. Fearing they might not be crucial enough for the company after privatization, they could create many obstacles hindering smooth implementation in fear of losing their jobs. Also, if they do not really desire privatization and believe they would benefit from it, they would never be able to convince their subordinates to fully accept it. Implementing privatization raises many questions about their futures: Would they be able to survive in the new system? Would they need training? Would they be able to keep their positions? Would they benefit from the new system? All these questions and others need answers that would make them feel secure and sure about their futures. Many incentives could be applied to encourage positive attitudes among managers. Among these are encouraging management buy-outs, offering stock for managers at lower prices or simply involving management in decision making. The starting point is recognizing that managers of SOEs have the ability to make things difficult; they ought to be motivated to get things going.

- Clarifying the situation for the work force and specifying their options; It is the executives and managers' task to clarify the situation to their subordinates, employees and workers. They should provide them with a full picture of the changes that are to take place. Whether the company would be restructured or sold they should give them sufficient information concerning the procedures that would take place. They should give them answers to questions like when the changes would take place, what their role would be, would they be asked to leave, do they have alternatives and if they stay would there be changes in their positions or salaries. Clarifying the situation would reduce possible resistance and increase feasibility of implementation.
- Restructuring the unit if needed: In this step companies implement Government restructuring policies and plans according to procedures recommended by specialists at the industry level and approved by Government representatives at the policy level. It could entail comprehensive restructuring of the enterprise or partial restructuring of an area with problems, e.g. financial restructuring. Successful reform of SOEs would stop the drain of losses and increase the possible selling price for the company
- Clearing the entangled situations related to previous privileges, contracts or obligations: Being government owned many privileges were given to SOEs, e.g. subsidies. When preparing the unit for sale decisions have to be made concerning which of these privileges would be stopped and which would be continued and for how long. Companies to be sold as going concerns would also have different contracts and obligations with time limits. They should be studied and dealt with carefully on a case by case basis.

- **Apply the most appropriate privatization technique for the company**

Here, plans change into action. The responsibility for applying the appropriate privatization technique, decided at higher levels, lies with the relevant privatization agency. Their success in individual companies requires timely implementation of privatization programmes. Obstacles hindering timely implementation should be reported on a regular basis to the monitoring body which, on its part, should report it to those responsible for planning and policy making. The latter will need to act to deal with any obstacles identified by the monitoring body.

- **Prepare feedback for the monitoring system**

  Feedback related to actual implementation at the enterprise level should be secured for different companies from the implementing agency. If the company is being restructured how much of the restructuring plan has been implemented should be monitored and if the progress was not up to the expected rate, reasons should be investigated. If the company was to be sold effective monitoring should raise many questions in order to be able to follow up actual implementation and to detect possible problems. Examples of these questions are: Was the company actually offered for sale? Was it attractive to investors? Did it realize the expected price? Was the selling mechanism appropriate? Were there any problems? What were they? And, could they be avoided in future sales? Managers of SOEs have to be actively involved in the restructuring process and the success of the privatization process as well as the enterprise after privatization will depend on the effectiveness of the restructuring as well as the morale and capabilities of the managers.

#### 2.9.2.3 Comments

It is evident from the above steps how the three necessary conditions for reform success Galal (1995) mentions (desirability, feasibility and credibility) have a direct effect on the implementation process. Existence of these conditions at both the policy-making and the implementation levels is essential for the implementation of privatization. To be feasible, genuine desirability of the privatization policy should exist at both levels. Timely implementation of the specific programmes would indicate credibility to stakeholders (especially managers) and would prove that the Government is able to fulfil what it promises. Creating an appropriate environment with a fully developed legal framework and adopting successful marketing efforts on both the local and international levels would also increase feasibility of implementation.

The model presents the importance of the Government role at the policy level and the executives and managers' role at the implementation level. Hence, the researcher finds it of great importance to investigate the political commitment to privatization and the executives and managers' views and attitudes concerning the different aspects of implementation. The researcher will focus on several steps of the model assessing actual implementation in the Egyptian context and highlighting problems that could create obstacles to the smooth implementation of privatization and what the managers' views are about them.

## 2.10 Conclusion

Since the 1980's privatization has gathered momentum and has made an impact not only in the western world but also among former socialist countries. In Egypt actual talk about denationalization and privatization began in the early Nineties. In 1991 privatization was announced as a Government policy.

Different authors have interpreted privatization in different ways. Yet, all privatization has been interpreted as either transfer of ownership (and management) or management only, of commercially oriented public enterprises from the government into the private hands.

One of the main reasons for privatization is the low efficiency of public sector enterprises reflected in their failure to achieve most of their goals (Galal, 1995). However there are some views that are skeptical about the ability of privatization to improve performance to the benefit of society.

Since privatization is a major change in the life span of any firm, it was found beneficial to review literature concerning management of change besides literature concerning privatization in Egypt. It was found that managers who are the *'masters of change'* according to Thorne (1991) have a role of ultimate importance in any process of institutional change and even more in the case of privatization (Clark and Soulsby, 1995, Whitely and Czaban, 1998 and Johnson, 2000). Their acceptance and enthusiasm have direct effects on the smooth implementation of the new policies (Kruger, 1995 and Dobni et al, 1996). Privatization is usually a change imposed from the top and so there are special issues related to how to make the managers the owners of change. In doing this it is necessary to overcome their resistance and make them feel that they are in control and that they can benefit from the change. These are major challenges for any privatization programme.

A model of "good privatization practice" which would hopefully avoid many of the problems of implementation concludes this chapter. The main purpose of the model is to provide a benchmark for assessing practice in Egypt. Hence, the following chapters examine different practices in the light of the model in an effort to identify the major problems hindering implementation of privatization in Egypt and whether they are at the policy making level, the industry level or the enterprise level (see figure 2.3).

# Chapter Three

## Public Sector Performance, Reform and Privatization in Egypt: An Overview

### 3.1 Introduction

Starting from the end of World War II an increasing number of State Owned Enterprises were initiated worldwide. Egypt was not different; starting from the Fifties a large public sector developed and expanded. This chapter aims to present a brief account of the context for privatization. It describes the public sector, its development, underlying rationale and its contribution to the problems of the economy summarizing the different government reform efforts and how privatization is related to them.

The chapter starts by describing the stages of development of the public sector in Egypt. Next, it discusses justifications for State Owned Enterprises (SOEs) to lay the ground for assessing whether they have succeeded in achieving their objectives. SOEs' performance is then compared with that of the private sector highlighting the major factors that might hinder public sector performance. The chapter also gives a short account of different government efforts to reform the public sector and the Economic Reform Programme currently implemented leading to the rationale and different reasons for privatization in Egypt. Finally a few of the possible problems related to privatization are then discussed.

### 3.2 The Role of the Public Sector in Egypt

#### 3.2.1 An Overview

In Egypt, the public sector was almost unknown as a power of development until 1952. It was introduced by the July Revolution[1] which announced that developing the national economy was one of the new Government's main objectives. In a few

[1]The July Revolution took place in 1952 overthrowing the King and, later, declaring Egypt a Republic. The new rulers had rather socialist tendencies.

years the Government became a major manufacturer, trader, banker and company owner.

The Government adopted a 'central planning' approach to develop the economy. The major objective was to build a strong industrial economy and at the same time limit private sector influence. Consecutive five-year plans were announced and many Government enterprises were established in the industrial, agricultural, construction and the service sectors. Also, existing private businesses were, in most cases, nationalized. The public sector became the major economic power.

Although the public sector succeeded in achieving some of its objectives during the period 1952-1974 it had major drawbacks. The public sector enabled the Government to develop many industries, to employ more workers, and to decrease economic dependence on the Western world. It also helped in coming out safely from one of the most difficult periods in Egyptian history when Egypt was involved in three consecutive wars. Nevertheless, problems of the Egyptian economy increased: The balance of payments deficit increased, local and foreign debt multiplied and inflation boosted. The public sector was partially responsible for these problems. It failed to develop its production methods, to increase exports or to compete effectively with imports.

With the beginning of the Seventies the Government tried to face these problems by applying the "*Open Door Policy*". The objective of the new policy was to decrease the role of the public sector by encouraging the private sector and increasing its role, while keeping the size of the public sector stable. Eventually, it was thought, problems caused by the public sector would disappear, especially that reform programmes for existing SOEs were also included in the plans in an attempt to increase their efficiency. The policy aimed to develop the private sector by attracting Foreign and Arab investment to establish new projects in Egypt. It also enforced major steps in liberalizing foreign currency exchange. However, the new policy was not as successful as planned. Lack of integrity decreased its effectiveness and many problems were left unsolved. Although encouraging foreign capital did solve the problem of capital scarcity, the many benefits given to enterprises owned by foreigners frustrated national investors and were considered unfair by many.

The Government's restructuring programme in 1978 did not make much difference. Implementation was slow and limited. Economic indicators continued to show increasing public sector losses, rising inflation, deteriorating trade and national budget deficits.

Although the GDP did grow at an annual rate of 8.5%, in the period 1974-85, most of the growth was due to foreign assistance, borrowing, oil related exports, remittances from Egyptians working abroad, tourism revenue, Suez Canal dues and foreign direct investment. Most of these flows could fluctuate dramatically, making them unreliable economic growth sources (Galal, 1995). Thus, concern over economic stability persisted.

A more comprehensive reform approach was adopted in 1987. An economic reform programme was initiated in 1987 and completed in 1991 by issuing the Law 203/1991. This law was meant to be a framework for reorganizing the public sector and introducing privatization. Several privatization programmes followed. In the next section the development phases of the public sector in Egypt are presented in more detail.

### 3.2.2 Major Stages of Development of the Public Sector

The public sector in Egypt has undergone major developments over the past forty years. From a very limited role in the early Fifties it grew into a huge force in the late Sixties and early Seventies. Then, it started a climb down paving the way for a growing and influential private sector. One can identify 5 major stages (Hassan, 1989) in this development.

- **The Pre-1956 Period**

The Government interfered very little in the economic life. There were almost no industrial enterprises owned by the Government. Most investment projects were undertaken by small or medium sized entities owned privately. The objective of rare Government interventions were to support or protect the private sector. After 1952 (July Revolution) Government intervention in economic activity increased with the ambition of satisfying industrial needs and achieving economic self-sufficiency.

❖ **The Nationalization Period (1956-1964)**

Wide nationalization moves in different sectors started to take place. The Suez Canal Company was the first to be nationalized in 1956. Misr Bank, The National Bank of Egypt and Belgium Bank soon followed in 1960. In July 1961 the Socialist Laws were issued and many enterprises were nationalized. The move was not limited to large entities, but almost every medium-sized business and, in some cases, small projects were nationalized. From now on it was the State that was to be the sole player in the field. Yet, the administrative apparatus was not well prepared to run the new entities efficiently. The common people looked up at the President as their 'hero', but many specialists thought otherwise.

❖ **The Holding Institutions Period (1964-1974)**

Several public-sector-organizing laws were issued. In 1964 Law 90 was issued followed by the more deliberate Law 32/1966 to reorganize the public sector into large holding public entities and affiliated public companies. In 1971 the new Law 60/1971 reorganized the public sector companies into 26 specialized holding public institutions supervising 321 affiliated companies. The holding institutions were to set objectives, lay out general plans, exercise control and evaluate the performance of the affiliated companies. The objective was to develop the national economy and to 'protect it from private sector mischief'.

❖ **The Open Door Policy Period (1975-1983)**

In 1975 the Government adopted a new policy of liberalization of the economy. The main goal was to break away from decades of inward looking, public-sector-led development strategy, to encourage and expand the role of the private sector in economic activities and to attract more investors from abroad. The Government also started a new scheme of Public Sector development. It issued Law 111/1975 that canceled the holding public institutions and established a higher council for each sector to give SOEs more autonomy and greater decision-making authority and to group units with similar specialization together.

However, the changes were limited and superficial and added very little to the old system. The economy continued to be dominated by the public sector, price control of key goods and services, multiple and overvalued exchange rates, negative real interest rates, and excessive control over credit allocation and trade flows (Galal, 1995). The role of the 25 established councils in the public sector was very similar to the holding companies' role. The main difference was that the councils did not own the affiliated companies. This had the negative effects of hindering central planning and due to the lessened authority of the Councils over the SOEs, the optimistic plans of developing the public sector and employing the latest technology were not realized.

### ❖ The Reform Efforts Period (1983-1991)

In an effort to overcome the limitations of Law 111/1975 a new law was issued to reorganize the public sector companies. The new Law 97/1983 kept the stock form of the SOEs, but cancelled the Higher Councils and re-established the holding company system. The system was very similar to the one established in 1964. Companies with similar activities were grouped together under the supervision of 28 holding companies of different specialization. The holding companies were to plan, coordinate and control the affiliated companies' activities. The holding institutions were owned by the Government and acted as a link between it and the SOEs.

In 1987 the Egyptian Economic Reform Programme (EERP) was initiated with public sector reform as one of its main objectives. Complementary to the reform efforts Law 203/1991 was issued in 1991 to introduce privatization and reorganize SOEs.

The following table is a brief picture of how the public sector companies on which the law was to be applied were like, right before the law was issued and after nearly four decades of public sector companies' dominance.

**Table 3.1: Public Sector in 1990/91**

*Million Pounds*

| Statement | Year 1990/91 before Law 203/91 |
|---|---|
| Total number of companies | 320 |
| Number of holding institutions | 31 |
| Number of companies making profit | 101 |
| Surplus before tax in millions of L.E. | 952 |
| Number of loss making companies | 219 |
| Current deficit in millions of L.E. | 3 100 |
| Net losses for public sector companies in millions of L.E. | (2 148) |

*Source: Public Sector Information Center, 1993*

As evident from the table more than two thirds of companies made losses with a current deficit of L.E 3100 million. If both the surplus and deficit were added the net losses are L.E. 2148 million. What made things worse is that these figures hide large amounts of direct and indirect subsidies offered to these companies by the GOE.

In preparation for privatization, Law 203/1991 has reorganized the public sector companies into 27 holding and 314 affiliated companies. The affiliates were distributed functionally such that affiliates of the same activity were under the same Holding Company (HC). Out of those companies only 33 affiliates have a small private share and are registered at the Stock Market. Those affiliates hold shareholdings in more than 200 Joint Venture Companies, established under Law 230/1989 for Arab and foreign investment. The new law has allowed partial and full sale of SOEs for the first time. It also gave managers at all levels a much higher degree of autonomy in decision making.

In Egypt, *corporatization* was used for a long time as the main SOE reform method. However, most Egyptian SOEs, although organized as corporations, lack at least one of the essential attributes and one or more of the organization and incentive structures of the modern corporations mentioned by many of the authors (e.g. Muir et al, 1995). This is why most previous reform efforts were unsuccessful. Most SOEs lacked a clear separate commercial identity and suffered from Government interference in their daily work with a vague distinction between ownership (Government) and management functions. This interference was also against the rule of company-level autonomy in decision-making, which gives the private sector the advantage of more timely decisions, based on commercial considerations. In contrast the SOEs were always affiliated to an Authority or HC that in its turn was affiliated to a Ministry or Minister with many of the simplest decisions having to take place at the highest levels. The complex structures of the large holding organizations often made the use of timely information to monitor and discipline daily work impractical or even impossible. The State was not able to enjoy the advantages of limited liability either. Most SOEs were granted financial facilities and debt terms that were way beyond what was economically justified. Consequently, most SOEs had problems in repaying these debts and the State had to bear their losses. Further, it was forbidden by law to announce bankruptcy of any SOE which meant that the Government which acted, as collateral, had to financially help losing companies. The Government had to bear all the risks without the benefit of limited liability. The fourth attribute of corporations (Muir et al, 1995) which is transferability of shares was also missing in Egyptian SOEs. Until the recent Law 203/1991, shares of SOEs were not transferable. This meant that once the shares were issued their ownership stayed constant.

Many efforts were also exerted to use internal incentives as a major tool of restructuring. Although details of internal incentives systems varied from one SOE to another, most analysts agreed that till 1991 they were not very effective systems (Afify, 1991).

In short, SOEs were an ailing component of the economy. Arguments over their justifications and their performance became more intense. The following section assesses the justifications put forward for state ownership of enterprises together with the private sector 'alternative'.

## 3.3 Rationale and Major Justifications for SOEs in Egypt: A Discussion

The major justifications for the existence of public sector enterprises in Egypt can be divided into five groups (Afify, 1991):

a) Social reasons: Ascertaining social justice and protecting consumers against the sometimes greedy private sector.

b) Creating new jobs and offering job security.

c) Preventing private sector monopolies and guaranteeing control over strategic natural resources and national services and industries.

d) Economic reasons:

i) Making profits to raise funds needed for other government services or activities; and

ii) Absence of able private sector that is willing to invest in big projects

e) Political reasons including all of the above in an effort to win popularity, especially among the masses.

Social reasons could be summed up in trying to secure social justice and fair income distribution. The theory was that SOEs would produce good quality products at low prices, guaranteeing availability of the products and jobs for the citizens and at the same time preventing misconduct of the private sector. This was assumed to help the poorer sections of the population face the continually rising cost of living.

Unfortunately, mixing social, political and economic aspects in decision making led to a very different outcome of the system (Afify, 1991):

- Uneconomic ways of financing accumulating deficits of SOEs, resulting from uneconomic production, negatively affected the economy, hindering growth and decreasing real job opportunities, while increasing inflation and hence the cost of living. This negatively affected the poor before the rich.
- The subsidized low-price products were available for both the poor and the rich, which meant that large amounts of funds were unnecessarily given to those who did not need them.
- Uneconomic prices in many cases encouraged mis-utilization of resources and the creation of black markets.
- Low investments in renovations and expansions lead to a limited increase in real job opportunities. When the Government insisted on offering more jobs, over-staffing and disguised unemployment were inevitable.

Curbing private sector monopolies as a major justification for SOEs overlooked the fact that privatization is by nature for competition and against monopolies. It also overlooked the fact that monopoly power can be reduced by introducing competition and can always be regulated. Furthermore, in many cases SOE monopolies didn't prove to be better anyway. Poor management, under-pricing, over-staffing and low spending on maintenance and renovations resulted in low quality and high costs. In other words the service or product ends up reaching only a small portion of the population, not because of overpricing but because of mismanagement (Shirely, 1989). Accordingly one can say that hazards of monopolies exist whether the ownership is private or public. If proper rules and regulations are implemented, private sector monopolies might be easier to regulate than SOE monopolies because with the latter, it is difficult to separate regulation from the management and ownership functions (El-Nagar, 1991).

Perhaps control on natural resources is the only justification for SOEs that could hold in some cases. But even there, definition of what is considered natural resources should be clear-cut, so that the Government does not end up running shops, biscuit factories and cafeterias. Besides, country experiences show that private sector companies are often better equipped than SOEs in managing many natural resources due to better management and more advanced technology, e.g. in the petroleum industry.

In the national service and industry sectors, a clear distinction must be made between what is better done by the government and what could be left to the private sector. Governments should also differentiate between the decision of providing a service and the task of actually producing it. Contracting out and leaving the task for private ownership or management is a viable option in many cases. Introduction of competition could be of great benefit in other cases, forcing SOEs to improve their services.

Although some individual SOEs have proved to be profitable, aggregate financial results of SOEs in different countries have in most cases been negative, either because of poor management or due to losses created by Government decisions to pursue social and political objectives through SOEs. Large deficits were in most countries financed by a mixture of subsidies and transfers from the Government budget, borrowing from the domestic banking system and external borrowing. Measurement of the actual fiscal effect of the financial burden is very difficult, especially since all the subsidies do not appear in the Government budget. However, a study covering 16 developing countries (Robert et al, 1984 and El-Naggar, 1988) showed that the net fiscal burden of Public Enterprises[2] (PEs) is responsible for a significant proportion of budget deficits. In Egypt, the study states that the net fiscal burden represents around one fourth of the total budget. Another study estimated that a 5 percent reduction in SOE operating costs would reduce the fiscal deficit in most developing countries by one-third (Galal, 1995).

The absence of sufficient private capital willing and able to invest in large projects was also a major concern for those who supported SOEs. Here a distinction must be made between public provision and public production. Once a government decides to provide a service, it could delegate actual production to the private sector. Contracting out certain tasks to one or more private sector companies could do this. Also large stock holding companies could be established to finance large projects. Solitaire Company in charge of the reconstruction of entire neighborhoods in Beirut is a good example of such an approach.

Naturally, politicians always prefer policies that make them more popular and help them retain their power for as long as possible. They usually prefer policies that give direct, short term, tangible benefits to long term plans that are expected to show their results in the far future. The public sector was used as a political tool giving people cheap products, jobs, health care, insurance and a lot of other advantages for many years. Unfortunately, this was not done on economic grounds in most countries. Although very popular at the beginning, poor management and non-economic methods of financing aggregate deficits made the public sector a very expensive way of buying political power. Although reluctant and perhaps resistant at first, most politicians realized this and *eventually* changed or *were forced to* change.

## 3.4 Did the SOEs Succeed in Achieving their Objectives?

The main criterion for evaluation of any project or policy is the degree of success in achieving its objectives. In Egypt three decades of experience show that the public sector achieved very little of what it was established for (Afify, 1991).

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[2]Different authors use different terms describing State Owned Enterprises (SOEs). Researcher used the terms SOEs and Public Enterprises (PEs) interchangeably.

- **Development Objectives**: Different studies show that in spite of thirty years of public sector control most development objectives were not attained. Most economic indicators including unemployment, inflation, indebtedness and Budget deficit reflect failure of the public sector in performing its desired development role.
- **Distribution Objectives**: The public sector also failed in achieving its distribution goals. The subsidy system on which it depended helped in creating disequilibrium in many product and service markets. Costs of overstaffing, subsidies and SOE losses contributed to the continuing Budget deficit and the deficit-financing problem. Both adversely affect the low-income groups in society as a result of increasing prices that exceed any subsidies they might receive (Afify, 1991).
- **Financial Objectives:** Initial public sector planners assumed that SOEs would make enormous profits that could be reinvested, covering the difference between available capital and the increasing investment needs. Unfortunately, this was not the case. Financial results of SOEs were in most cases either negative or very low.
- **Political Objectives**: One of the main goals of the public sector was liberalizing the Egyptian economy from foreign economic domination. The increasing Gross National Debt shows that this has not been attained.

## 3.5 A Comparison Between Private and Public Sector Performance

A short comparison (Rashed, 1997) between private and public sectors in Egypt shows a big difference in performance (see tables 2.2, 2.3 and 2.4).

- **Low Ability of the Public Sector to Generate GDP**

A quick look at Table 3.2 shows efficiency of the business sector in generating GDP compared to its investments. One notes:

- The Public sector contribution to GDP at fixed prices has varied between 36.4% and 36.9%, while the total amounts invested in them varied from 53.5% to 63.3% in the period 1987 to 1993.
- By contrast the private sector generated between 63.1% and 63.6% with investments ranging between 36.7% and 46.5% in the same period.

### Table 3.2: Distribution of Some Economic Indicators between the Public and Private Sectors

Percentages

| Year | GDP ( Fixed Prices) | | | GDP (Current Prices) | | | Total Investment | | | Work Force | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Public Sector | Private Sector | Total | Public Sector | Private Sector | Total | Public Sector | Private Sector | Total | Public Sector | Private Sector | Total |
| 87/88 | 36.6 | 63.4 | 100 | 37.7 | 62.3 | 100 | 63.3 | 36.7 | 100 | 32.6 | 67.4 | 100 |
| 88/89 | 36.9 | 63.1 | 100 | 36.7 | 63.3 | 100 | 54.1 | 45.9 | 100 | 32.3 | 67.7 | 100 |
| 89/90 | 36.6 | 63.4 | 100 | 36.1 | 63.9 | 100 | 58.1 | 41.9 | 100 | 31.9 | 68.1 | 100 |
| 90/91 | 36.4 | 63.6 | 100 | 39.9 | 60.1 | 100 | 57.5 | 42.5 | 100 | 31.9 | 68.1 | 100 |
| 91/92 | 36.5 | 63.5 | 100 | 38.8 | 61.2 | 100 | 53.5 | 46.5 | 100 | 31.7 | 68.3 | 100 |
| 92/93 | - | - | - | - | - | - | 60.7 | 39.3 | 100 | - | - | - |

*Source:* Rashed, Moatasem, "Management of Change", paper presented to the Conference The First Annual Conference: Requirements of Economic Reform in Egypt, Faculty of Commerce, Zagazig University, 26-27 April 1997.
N.B. Rashed's Sources: Calculated from data from the central control department in the Ministry of Planning.

- **High Cost of Job Opportunities in the Public Sector Compared to that in the Private Sector**

Table 3.3 shows the cost of creating job opportunities in the public and private sectors during the period 1987 to 1993. The figures show that creating each new job opportunity in the public sector costs about five times the cost in the private sector.

### Table 3.3: Cost of Each New Job Opportunity *

| Year | Implemented by millions Investments of pounds | | | Increase in work force by thousands | | | Cost of Each New Job Opportunity | | |
|---|---|---|---|---|---|---|---|---|---|
| | Public Sector | Private Sector | Total | Public Sector | Private Sector | Total | Public Sector | Private Sector | Total |
| 87/88 | 13038.3 | 7569 | 20607.3 | - | - | - | - | - | - |
| 88/89 | 11228.9 | 9508 | 20736.9 | 82 | 282 | 364 | 136.94 | 33.72 | 56.97 |
| 89/90 | 13476.2 | 9705 | 23181.2 | 64 | 311 | 375 | 21.57 | 31.21 | 61.82 |
| 90/91 | 14534.2 | 10758 | 25292.2 | 101 | 188 | 289 | 143.9 | 57.2 | 87.52 |
| 91/92 | 13440.8 | 11666 | 25106.8 | 78 | 285 | 363 | 172.32 | 40.93 | 69.16 |
| 92/93 | 16310.8 | 10550 | 26860.8 | - | - | - | - | - | - |

*Cost of each new job opportunity = Allocated Investments / Increase in work force.
*Source:* Rashed, Moatasem, "Management of Change", paper presented to the Conference The First Annual Conference: Requirements of Economic Reform in Egypt, Faculty of Commerce, Zagazig University, 26-27 April 1997.
N.B. Rashed's Sources: Ministry of planning, Central Control.

- **Poor Allocation Efficiency in the Public Sector Compared to the Private Sector**

As evident from Table 3.4 the public sector is more dependent on the capital element of production in spite of its proportional scarcity. The private sector on the other hand depends more heavily on the abundant human factor.

**Table 3.4: Investment Productivity and Labour Productivity**

| Year | Invested Pound Productivity (i) | | | Labour Productivity by Pound (ii) | | |
|---|---|---|---|---|---|---|
| | Public Sector | Private Sector | Total | Public Sector | Private Sector | Total |
| 1987/ 88 | . 0.207 | 0.815 | 0.430 | 4623 | 3876 | 4120 |
| 1988/ 89 | 0.415 | 0.992 | 0.679 | 4750 | 3879 | 4160 |
| 1989/ 90 | 0.884 | 1.040 | 0.949 | 4824 | 3906 | 4198 |
| 1990/91 | 0.656 | 1.690 | 1.097 | 4835.4 | 3956.5 | 4237.2 |
| 1991/ 92 | - | - | - | 4953.1 | 3999.3 | 4301.2 |

i) Productivity of each invested pound = Increase in GDP in current prices / Total fixed investment in the previous year
ii) Labour productivity = GDP in fixed prices / Number of employees.
*Source:* Rashed, Moatasem, "Management of Change", paper presented to the Conference The First Annual Conference: Requirements of Economic Reform in Egypt, Faculty of Commerce, Zagazig University, 26-27 April 1997.

N.B. Rashed's Sources: Ministry of planning, Central Control.

Of course to make a more rigorous comparison would require comparing capital intensity, job creation and profitability for public and private enterprises in *the same* industrial sectors, but this would be beyond the scope of this study. Yet in a country like Egypt where capital is in short supply it might have been more appropriate to concentrate more on labour intensive projects and enterprises.

## 3.6 Factors Hindering Public Enterprise Performance

The main factors that negatively affect the performance of SOEs in Egypt are (Afify, 1991):

- Continuous interference of politicians in the internal affairs of SOEs (usually for political reasons) decreases the chances of taking the right decision at the right time.
- The public sector performance is usually restricted in taking efficiency enhancement decisions:-
  - Increasing selling prices when needed is restricted.
  - The Government has continued to employ graduates whether actually needed in the projects or not, causing a problem of redundant labour in most SOEs. At the same time, laying off the excess labour is in most cases very difficult.
  - Financial and liquidity problems of different companies usually limit the possibility of renovation and replacement.
  - Compulsory continuation of production of losing products or services for political reasons.
  - Managers are not always selected for objective reasons.

- The necessity of different Government authorities' approval in day-to-day details causes delay, vague accountability and little initiative.
- Accountability in SOEs is, on occasions, neither accurate nor objective.
- SOEs' General Assemblies organized by the previous law proved to be unsuccessful in effectively performing the owner's role of directing and controlling the Boards of Directors.
- Labour laws limit management authority in dealing with the work force economically.
- Bureaucracy represented by the many necessary licenses, procedures and approvals needed to perform any task is not suitable for the continually changing requirements of the business sector.

• The Government usually subsidizes SOEs whether directly or indirectly. Financial assistance, unlimited overdrafts and loans and leniency in evaluating true feasibility of projects allowed SOEs to evade the normal financial market constrains the private sector is exposed to. In fact the previous law made it nearly impossible to liquidate any SOE no matter how unsuccessful it was.

• The public sector system gave wider opportunities for some corrupt behaviour, e.g. bribes and black markets. The problem is more ingrained when SOE executives succeed in lobbying with politicians, exchanging benefits at the expense of the public interest.

All these factors whether separate or combined with others made many SOEs in Egypt increasingly similar to governmental non-commercial structures in their organizations, governance and funding. Many of them changed into large State holdings with many of the negative features of inefficient bureaucracies rather than large industrial projects utilizing Government resources to serve development objectives as was intended.

The following section discusses briefly the Egyptian Economic Reform Programme, which was meant to overcome many of the previous problems and of which public sector reform was a main component.

## 3.7 The Egyptian Economic Reform Programme (EERP)

Any discussion of about the current Egyptian economy must start by discussing the ongoing reform programme. The programme of which privatization later became a major component started in 1987. Its major objective was to improve the performance of the Egyptian economy through its transformation from a centrally planned to a market economy. It includes major measures that have been taken by the Government to prepare the environment and make it more favourable for implementation of privatization.

### 3.7.1 Why Was Economic Reform Essential?

Four decades of changing models and altering economic policies did not succeed in transforming Egypt into a developed or a fast-growing country. On the contrary, economic performance has been poor and chronic problems persisted. Fundamental areas of imbalance continued to characterize the economy externally and internally. The poor economic performance, reflected by the different economic indicators, forced the government to develop a comprehensive reform programme.

One of the major indicators that showed this necessity was the continuous deficit in the. National Budget. The deficit reached 26.5% of GNP in 1987/88. The deficit was financed by the local banking system and the different saving vessels increasing the total State debts to L.E.4785 million pounds in 1986/87 and L.E. 8130 million pounds in 1988/89 (Hasabou et al, 1994).

Another indication showing the necessity of reform was the rising inflation. The wholesale price index reached an average of 22.1% during the period 1985-90. This was an inevitable result of the decrease in gross supply compared to gross demand (Hasabou et al, 1994).

Egyptian imports also increased at an accelerating rate while exports did not increase at the same rate, hence the trade deficit increased from only L.E. 33 million in 1952 to an alarming L.E. 5665 million in 1987 (Afify et al, 1989). The Government's answer to these problems (and to declining oil prices and increased interest rates) was import restriction and external borrowing. The import restrictions, the high tariffs and the overvalued exchange rate resulted in lower exports and therefore lower foreign exchange earnings, and higher imports. One way to deal with this imbalance was external borrowing, which gradually became the norm. Indebtedness to the outside world reached record levels in the Seventies and the Eighties. Total debt equaled 73% of the GNP in 1986 and servicing it absorbed 41% of exports in the same year (Afify et al, 1989).

Weakness of the gross savings rate was another reason that made reform essential. National investment succeeded in covering only 30.1% of the national investment budget deficit in 1987/88. Furthermore, the social and economic environment continued to be inappropriate for foreign investment (Hasabou et al, 1994).

The uneconomic pricing policy the government pursued resulted in the misallocation of resources. The cheap, subsidized products encouraged unreal demand and hence excessive consumption exceeding production and abolishing any chances of exporting. Administrative pricing also affected the private sector. It resulted in distorting the investment behaviour, i.e. encouraging the private sector to concentrate on activities realizing quick profits (e.g. consumption industries, construction, trade, and commission and franchise agencies) rather than long-term projects.

Increasing losses of SOEs and their inability to cover their current and investment needs resulted in increasing their dependence on the Government Budget and the banking system for financial assistance, regardless of the long-term results. Limited restructuring procedures of the public sector had already proved to be insufficient and hence structural adjustment of the whole system became unavoidable.

Starting from the early Sixties and until the late Seventies the Government took upon itself the responsibility for employing every university graduate either in the public sector or in the different State Administrative Departments. The result was a steady increase in disguised unemployment, lower labour productivity and a rise in public sector costs. In the early Eighties the Government admitted its failure to create sufficient jobs for the newcomers and started to gradually give up the graduate employment policy. The unemployment rate increased accordingly from 7.2 % in 1982/83 to 17% in 1986/87 and to 20% in the early Nineties (Aly, 1994).

The National Budget could no longer tolerate the increasing demand for financing infrastructure and services provided by the Government. The internal and external debt burden used up most of the National Revenues necessitating consumer participation in part of the actual costs of these services. Encouragement of private sector investment in these sectors became essential.

The old system also had some social effects that made reform necessary. Total dependence on the Government to provide education, health care, housing, and job opportunities was an attitude that needed change. Likewise loss of interest in the social and political life and low participation in national elections were matters of concern for the Government.

All these poor economic and other indicators led the Government to seriously consider the overall transfer to more liberal economic policies since the central planning and public sector model had not helped the country achieve its development objectives. The international organizations (IMF and the World Bank) gave encouragement, advice and blessings to this transformation.

### 3.7.2 Objectives of the Egyptian Economic Reform Programme (EERP)

The Government announced several objectives of the EERP (Hasabou et al, 1994).

- Decreasing National Budget Deficit.
- Improving individual living standards and guaranteeing availability of affordable products and services especially for the poorer sectors of the economy.
- Creation of jobs.
- Improving balance of payments.
- Balancing national revenues and expenditures.
- Curbing inflation.

The major Government strategies to fulfil these objectives could be summarized in the following points:

- Liberalizing market forces and encouraging private sector investment and production.
- Development of investment opportunities by improving infrastructure projects.
- Creating an atmosphere of political freedom and democracy.

- Government reform and development of its administrative systems.
- Controlling Budget deficit.
- Controlling Balance of Payments deficit.
- Public sector reform.

## 3.7.3 Economic Reform Components

The EERP works on two major dimensions:

- the Short-run Stabilizing Programme; and
- the Long-term Structural Adjustment Programme

### 3.7.3.1 The Short-run Stabilizing Programme

The programme was designed to be a short-run one aiming at solving the most persistent problems. It was to run from May 1991 until October 1992 seeking to decrease excess demand, to balance between the increase in payment means and the GDP growth rate (in the balance of payment) and to curb inflation. Accordingly the Government decided to pursue a group of financial and monetary and credit measures to attain these goals (Al-Ahram, 17 Sept., 1991).

### 3.7.3.2 The Structural Adjustment Programme

This programme was designed to run for a longer period of time. The initial plan was to be implemented within the first three years, but the adjustments would carry on, on a long-term basis (Rashed, 1997). The programme aimed at public sector reform, encouraging the private sector, liberalizing trade and prices and activating the stock market. The following lines present a summary of the different measures that mostly affect SOEs.

❖ **Public Sector Reform**

This was to be realized in two key steps:

- Reforming the Government system.

- Liberalizing public projects and restructuring those that needed reform. This also included privatizing some units and preparing others for future privatization. Law 203/1991 was issued to organize this step[3].

❖ **Encouraging the Private Sector**

Among the procedures to encourage the private sector were (Rashed, 1997):

- Liberalizing private sector investment
- Urging the private sector to own and manage public projects
- Minimizing necessary Government approvals and permits

These procedures did have a positive effect on private sector investment. During the period 1987/88-1991/92 the private sector investments reached L.E.25 billion representing 40% of the total investments for that period. The investments are estimated to have increased to L.E.70 billion, 50% of the total investments for the period 1992/93-1996/97 (Hasabou et al, 1994).

❖ **Liberalizing Prices**

Liberalizing prices started in the early Seventies. The objective was to gradually reach economic prices of production factors, intermediate products and end products. This was to be attained by gradually removing subsidies, increasing salaries, and stopping the use of different prices for different consumers. These measures were continued and reinforced by the following procedures (Rashed, 1977):

- liberalizing money exchange and interest rates;
- liberalizing prices of agriculture and industrial products;
- gradual increase in electricity and energy prices; and
- gradual increase in salaries.

❖ **Activating the Stock Market**

The Government issued Law 95/1992 to reorganize the capital and stock market in Egypt. The objective was to support the development of the capital

[3]Restructuring of public enterprises will be fully discussed in Chapter Six.

market at a rate suitable for the growing role of the private sector and at the same time to reactivate the long dormant stock market. Together with Law 203/1991 (permitting the sale of SOE stock), the new procedures succeeded in creating a more appropriate environment for stock market exchange reactivating the stock market and expanding the private sector role.

### 3.7.4 Comments on the EERP

Successful privatization largely depends on the appropriateness of the economic environment. Adopting a comprehensive approach of reform in the EERP was the major Government strategy for creating such a favourable environment. The EERP aims to transfer the economy from a centrally planned one to a free enterprise system.

According to Government official announcements (Al-Ahram, 5th May, 1998) EERP was well along its way in the late Nineties. Most of the planned measures had been implemented successfully and had positively affected the economic situation (Deputy Minister Interview). Implementation of the planned reform would certainly create a more liberalized environment, which is favourable to privatization. It would facilitate implementation of privatization and increase the feasibility of the whole policy.

However, some observers have concluded that the Egyptian reform programme was more successful on the macro level than at the institutional level (Galal, 1995). According to Galal macroeconomic reform succeeded in aligning the exchange and interest rates closer to market values, increased competition, reduced inflation and cut the fiscal deficit but institutional reforms lagged far behind.

## 3.8 Reform and Privatization

As shown in previous sections, major parts of Egypt's economic problems are directly related to the poor performance of the public sector. Also as mentioned before, studies have shown that around one quarter of the Government Budget deficit was a result of SOEs losses and that a mere 5% reduction in SOEs' operating costs would decrease the national Budget deficit by one-third. This relationship made it essential to adopt a comprehensive approach of economic reform of which a major part is concerned with public sector reform. The inability of SOEs to cover their current and investment needs and their increasing dependence on the Government Budget and the banking system for financial assistance made it essential for any reform to start by public sector structural adjustment.

Privatization represented an attractive alternative pursued by different countries with similar economic problems. It is also an option recommended, and may be forced, by external pressure from IMF, the World Bank and other international institutions.

The Egyptian reform programme was designed to be a comprehensive plan for upgrading the Egyptian economy. The major Government strategy under the programme for doing so included economic liberalization, encouraging the private sector and lowering aggregate public sector losses. Privatization was a complementary step to the economic reform program. It represented the major component of the structural adjustment policy within a comprehensive approach including reform of the whole system. The structure for implementing privatization as a major component of reform is discussed later in Chapter Four.

## 3.9 Why Privatize Egyptian SOEs?

Besides the general reasons for privatization, the following points can explain why many of the Egyptian analysts and officials have found privatization an answer to many of the economic and public sector problems.

### 3.9.1 Privatization Would Have a Positive Effect on the Egyptian Economy (Afify, 1991)

- Privatization was expected to reduce the budget deficit whether directly by decreasing direct and indirect subsidies to SOEs or indirectly by providing the Government with immediate sums of money that could be used in financing investments in new projects, restructuring old ones and economy and tax system reforms in general (the Budget deficit reached L.E20 billion in 1987).

- A free economy, with a more competitive system and no Government interference in the price system would lead to more efficient economic allocation of limited resources, and create a better environment for private investment.
- Privatization would allow small investors and SOE personnel to become owners of productive assets. This would broaden the ownership base and create incentives for better performance through increased loyalty and the benefits from ownership.
- Better income distribution could be achieved by many more effective methods than distorting the prices of SOEs' products and services, such as direct financial help to those who are in need e.g. vouchers and mobbing costs through tax revenue.
- A free competitive system, by nature reduces monopoly power and its exploitation by allowing others to enter a market and offer better services and products at lower prices. Also decreasing Government interference in the price system would put an end to black markets.

### 3.9.2 Privatization: A Worldwide Trend

The Egyptian privatization programme should be seen within the context of a worldwide trend. Privatization in the form of public asset sales and contracting out previously public managed services became an increasingly global phenomenon. Sader (1995) recorded 2655 transactions in 95 countries yielding US$271 billion in revenues between 1988 and 1993. The trend continued to gain momentum in the second half of the Nineties until privatizations worldwide increased by 10% in 1999 as compared to 1998 yielding Governments over $145 billion (Johnson et al, 2000).

The process of privatization began and was more intense in the developed world. In the Eighties, privatization sales in Western Europe alone exceeded $200 billion while the global total exceeded $600 billion, in the period 1980 to 1987 (Herman, 1997). Donaldson (1995) reports that sales in industrial countries amounted to US$ 175 billion in the period 1988 to 1993 which represented 85% of global privatization revenue and 15% of the number of global transactions. The World's largest sale occurred in Italy, where the Government sold a 34.5% stake in ENEL the country's largest electricity producer. The sale amounted to $14 billion. France earned around $ 10 billion a year from privatization in the period 1997 to 2000. In 1999 Deutsche Telecom yielded $10 billion to the German Government (Agence France-Press, 2000).

In the developing countries privatizations have similarly been occurring at an increasing rate over the past decades. During the 1980's large numbers of developing countries started privatization. The trend started in Latin America, with Chile being one of the first countries to begin privatization, and then spread all over the World (Donaldson, 1997). According to Sader's report the bulk of privatizations (57%) took place Latin America and the Caribbean region, followed by Europe and Central Asia with 18.7%. Subsaharan Africa and the Middle East and North Africa had only a small share in the period 1988 to 1993 (Sader, 1995). However, the total developing countries' share of global privatizations rose from 17% in 1990 to 22% in 1996 (The Economist, 1997).

Sales in states in transition to market economies (Poland, Hungary and the Czech Republic) have also stepped up. During the Nineties a variety of rapid privatization techniques were adopted in Eastern Europe and the former Soviet Union. Tens of thousands of medium and large enterprises and hundreds of thousands of small firms in Russia, Ukraine and the Czech Republic have been transferred to private hands (Donaldson, 1995). Poland recorded the highest activity in 1999 raising $ 3 billion from the banking-sector alone (Agence France-Press, 2000).

In short the Eighties and Nineties witnessed a global increase in sales of public assets everywhere.

### 3.9.3 Privatization and International Institutions

Since the early 1990's because of large debt burdens and an increasing budget deficit, there has been a growing trend towards privatization in developing countries. International institutions such as IMF, USAID, the World Bank, the Department for International Development of the UK, the Commonwealth Secretariat and the United Nations have originated or at least encouraged this tendency as an effective tool to reduce budget deficit and debt burden problems. Another objective was to increase the vitality of the public sector and to curb the drain of national resources caused by loss making public sector companies.

In Egypt, encouraging the private sector was given a great push ahead during the 1970's. The Government led by President Sadat adopted a new policy encouraging the private sector and competition, *"the open-door policy"*, after about twenty years of socialism and nationalization. However, the pace of private sector expansion slowed down during the Eighties, as a reaction to many problems that occurred due to the sudden change (e.g. inflation and the perceived over encouragement of foreign investment compared to national investment). In 1978 a restructuring program was initiated to reform the fiscal system and liberalize prices and the exchange rates, but actual implementation was slow and limited in scale.

In 1987 the Government adopted an integrative economic reform policy to face the economic crisis. The programme included restructuring measures for the Government monetary system in an effort to reduce public deficit, external debts and unnecessary Government subsidies, while preserving the strength of the local currency against other currencies and avoiding extra burdens on citizens. The major Government strategy for doing so rested upon the introduction of a package of monetary policy reforms and more encouragement of the private sector.

## 3.9.4 Expected Benefits of Privatization

A few of the expected benefits of privatization are summarized below (Afify, 1991):

- Ownership transfer increases efficiency[4].
- Selling a few SOEs would absorb the excess liquidity in the banking system and redirect it to serve national development objectives.
- Absorbing excess liquidity will curb inflation.
- Increasing the efficiency of the economy will positively affect the rate of development, national production and the Balance of Payments.

[4]See, Bishop and Thompson 'Privatization in the UK: Deregulatory Reform and Public Enterprise Performance' in Ramanadham, V.V., Privatization Global Perspective, Routledge, London, UK (1992).

- Implementing privatization necessitates a strong and dynamic capital market, which will serve investment, project promotion and development. It might attract more capital from abroad.
- The privatization programme encourages direct allocation of costs to users (e.g. toll charges). This means more justice in service cost allocation, consumption rationalization and facilitating management.
- More dependence on the private sector whether by lease, sale or contracting out, to enhance productivity, lower costs and achieve higher quality and better services.
- A more liberalized economy could also attract more foreign capital in the economy.

## 3.10 Problems of Privatization: A Discussion

Like any other new system, implementing privatization might face some problems. This section briefly summarizes a few of these problems (Moore, 1998 and Afify, 1991)

- **Loss of jobs:** The potential social effects, such as unemployment and increases in prices caused by reform and privatization might cause opposition amongst many categories of Egyptians. Actually fear of losing jobs could be considered the strongest reason for opposition to privatization by public sector employees and managers. The work force whether in organized unions or not, expect managers pursuing private sector objectives to react to over-staffing and disguised unemployment (two usual features of SOEs) by significant reduction in jobs. Public sector employees are definitely the most affected group by the new policy of privatization. They might resist it out of insecurity for their jobs or fear of losing their privileges. Opposing political parties and groups like Islamic extremists might also oppose privatization out of fear of its social effects.
- **Loss of Government control over strategic industries:** Since Nasser's time Egyptian economic activity has been dominated by the public sector. Most opponents of privatization want to keep it that way in fear that the private sector

might create monopolies and loss of Government control over strategic industries.

- **Increase in prices:** Along with reform and privatization and eliminating subsidies, there is usually an increase in prices.
- **Absence of an adequate capital market to finance the privatization process:** This problem is more evident in developing countries. In Egypt fear of the absence of adequate capital to finance the process was a major concern for policy makers. However, to their surprise all stock offered in the stock market was immediately bought with usual excess in demand that sometimes reached twenty times what was offered.
- **Fear of foreign interference in local economies**: This problem exists due to ideological reasons and anti-western feelings that are existent in many of the developing economies. It is also out of fear that opening the door to more private sector influence from abroad could amount to an invitation to Israel to influence the Egyptian economy. Another concern is suspicion that inflows of western ideas or capital will cause erosion of the moral and cultural fiber of Egypt.
- **Fear of Government losses as a result of under-pricing SOEs to facilitate their sale**: Under-pricing of SOEs is often used by governments to gain support from managers and employees as well as the general public for privatization. Actually, this is a concern raised by many economists, especially those against privatization. However, two main facts concerning this issue have to be clear in one's mind. If shares are sold to the public, managers and employees at a lower price than their actual worth, then it is simply a transfer payment where the gain of the higher value of the shares after the sale goes to the new owners. Also, where a state owned enterprise is in poor shape requiring restructuring there would be risks associated with owning the shares and this has to be reflected in the value of shares.

## 3.11 Conclusion

The public sector in Egypt has gone through several stages of development in the last three decades. Egypt now has a large sector with SOEs in a wide range of industries and services. The sector has also developed an overall context and culture, which includes enterprise objectives, relationship with government, expectations of managers and employees and the policy and legal framework.

A simple comparison of public enterprise performance with that of the private sector illustrates how unsuccessful the public sector had been. The case was made that SOE's have hardly attained any of their initial goals due to structural deficiencies.

The Egyptian Economic Reform Programme (EERP) aimed to change the Government role from a direct, interfering bureaucratic role to an indirect reforming role using a group of strategies and policies to direct supply and demand forces to serve social and economic development goals. *Indicative planning replaced central* planning and a minimum of laws were to be enforced together with a group of integrated financial, monetary and credit policies to prepare the economy for an increasing private sector role.

The EERP included two major components: the short-run stabilizing programme and the long-term structural adjustment programme of which public sector reform is a major constituent. According to Government officials most of the EERP planned measures have actually been implemented and have helped create a more favourable environment for privatization.

Privatization is an inevitable complementary step to the economic reform programme. It represents the major component of the structural adjustment policy. This makes privatization a part of the Egyptian comprehensive approach to reform.

In short this chapter discussed the roots of privatization demonstrating how the modest performance of SOEs gave reason and enthusiasm to policies of reform and later privatization. The privatization program would not, and indeed has not, gone without problems. Different problems were foreseen; some have been confronted and some are still causing concern. This study examines some of the major problems of privatization in Egypt. Subsequent chapters deal with commitment of policy makers and privatization (Chapter 4), managers' attitudes and resistance (Chapters 5 and 10), legal problems (Chapter 6), restructuring (Chapter 7), labour problems (Chapter 8) and valuation problems (Chapter 9).

# Chapter Four

# An Overall Assessment of the Egyptian Privatization Programme

## 4.1 Introduction

In order to fulfil the condition of feasibility privatization should be implemented by a clear structure with well-defined responsibilities to plan, organize and control the whole process. This structure would only be successful if it is backed by a Government truly committed to privatization in a favourable environment for implementation. This chapter aims to examine whether, in Egypt, those two conditions were satisfied. It first explains the structure governing privatization at both the policy and the implementation levels and then assesses actual Government commitment to privatization. This latter aim is attained by reviewing and evaluating privatization progress since its first announcement.

## 4.2 Preparing for Privatization

The Government privatization programme in Egypt was started in 1991 by a Presidential declaration that the Government will adopt privatization as the official Government policy, aiming for a more liberalized economy (Al Ahram, 1st May, 1990). At the time, most officials considered privatization an essential component in the Egyptian Economic Reform Programme, announced a few years earlier.

A new law, Law 203/1991[1], was issued soon afterwards to replace Law 97/1983, permitting partial and/or full sale of public sector companies for the first time. The law aimed to separate ownership from management replacing social-oriented management with profit-oriented management. It introduced the Holding Company (HC) concept for portfolio management. According to the new law, each holding company acquired the authority to sell or lease any asset or company affiliated to it.

[1] Adequacy of the legal framework will be discussed in detail in a separate chapter.

The law also allowed, for the first time, liquidation of public enterprises. The new law enforced equal treatment between public and private sector enterprises putting an end to privileges, e.g. subsidies and other financial advantages, previously enjoyed by SOEs. The Privatization Committee headed by the Public Enterprise Minister was set up to coordinate privatization activities. Under the new law the public sector companies were reorganized into holding and affiliated companies. The affiliates were distributed functionally such that affiliates of the same activity are under the same HC.

Law 95/1992 (Capital Market Law) was then issued to regulate and direct the emerging stock market as a part of the mechanism to activate market forces. The law regulates issues like enlisting in the Stock Market, steps to be taken and requirements for the completion of a sale transaction with special attention paid to Initial Public Offerings (IPOs). The Stock Market Committee has the authority to review the share valuation prior to IPOs. The Stock Market Authority is also authorized to interfere in setting the closing prices in case it was deemed necessary for the stability of the stock market and for the benefit of the traders later on.

The Public Enterprise Office (PEO) was established in 1992 by an agreement between the UNDP and the Government of Egypt to monitor and follow up the implementation of the privatization programme and reduce bureaucratic and red tape obstacles. PEO was established to facilitate monitoring and reporting and to coordinate the efforts made by the various parties on the side of the government (including HCs and their affiliates), the donors and their consultants as well as any other parties involved.

The Government decided not to include several sectors considered strategic in the privatization programme. These sectors represented 85% of Public Sector assets in Egypt (PEO's Director speech, 18th Sept., 1996), which means that only 15% were considered for widening the ownership base. The following sectors were excluded at that stage:

- Petroleum Sector
- Suez Canal
- Telecommunications
- Railway (with the exception of SEMAF Co.)
- Military Industries
- Egypt Air

- Insurance and Banking Sector (except joint venture banks)

The following is a summary (Public Enterprise Office (PEO) Director's speech, 18th September, 1996) of the public sector equity status before the privatization programme started. The total book value of assets of public enterprises at the end of June 1991 was LE 74 Billion (about US$ 25 billion) that were financed by:

- Equity share by the Government totaling LE 13 billion
- Long term loans and overdrafts of LE 26 billion
- Trade credits amounting to LE 21 billion
- Provisions & other credit accounts of around LE 14 billion.

## 4.3 Structure of Privatization in Egypt

This section briefly points out the different aspects of the new law and then describes the administrative body in charge of implementation.

### 4.3.1 Legal Framework: SOEs and the New Law 203/1991

Law 203/1991 was issued in 1991[2] as a step or a stage towards future full liberalization. Its main objective was to organize the privatization process. Law 203/1991 replaced Law 97/1983 as an intermediate step preparing the SOEs to be later governed by Law 159/1981, which governs private sector corporations.

The new law redefined the function of public enterprises, which used to include political and social roles leaving the individual companies to specify aims and strategies on commercial lines. Each SOE was to act as a legal entity managing its investments in its own best interests regardless of the Government's overall development plan. Management performance is to be evaluated according to quantifiable criteria, e.g. profit or at least decreasing losses.

The new law reorganized the public sector into a system of holding and affiliated companies. The 314 public enterprise Affiliated Companies (ACs) were grouped under 27 Holding Companies (HCs), later reduced to 17 companies and then

[2]Law203/1991 will be dealt with in a separate chapter. It is also included as an appendix at the end.

to 16 companies in 1996. The holding companies act as stockowners of the affiliated companies and are in charge of restructuring the affiliated companies and managing their stocks.

The new law increased the degree of autonomy at all management levels. It separated ownership and management completely. The role of the appointed HCs' and ACs' boards of directors, representing Government ownership, is limited to planning, policy making and monitoring performance. Actual implementation of strategies and policies is left for professional managers in affiliated companies under the supervision of their Boards of Directors.

The major objective of the Board of Directors became to carry out the Government's gradual liberalization policy. This is to be achieved by financial restructuring of the different companies and managing their investments and stocks in a manner that fulfils privatization and reform aims of the Government. As to the work force all those working in SOEs have been transferred to the new holding and affiliated companies. They were to keep the same positions, salaries, allowances and other monetary and non-monetary benefits.

### 4.3.2 Who is in Charge?

According to the new set up, the privatization implementing structure in Egypt was composed of four main agencies (Public Enterprise Office, 1994):

A. The Public Business Sector Minister (PE Minister)
B. The Public Enterprise Office (PEO)
C. The Holding Companies (HCs)
D. The Affiliated Companies (ACs)

This structure (see Figure 4.1) centralizes authority and responsibility for leading, planning and directing the privatization programme at the PE Minister level supported by the PEO. Decisions of selling specific enterprises and assets and implementing certain transactions are left for HCs and ACs. The following lines summarize duties of each layer of the organization:

**A) The PE Minister Responsibilities**

- Planning and guiding Government policies related to reform and privatization of public enterprises.
- Participating in building public awareness and national consensus supporting privatization.
- Approving and announcing the Government's annual privatization programme.
- Directing the PEO, HCs and ACs in implementing the programme.

**B) Public Enterprise Office (PEO)**

The Public Enterprise's office responsibilities are mainly to support the PE Minister in implementing Law 203/1991 and the privatization programmes. They could be summarized as follows:

- Preparing the annual privatization programmes together with the HCs and presenting them to the PE Minister and the Cabinet for approval.
- Serving as a channel for all legitimate contacts between the Government and the HCs and ACs.
- Proposing candidates for top managerial positions of HCs including posts of Chairman, Board of Directors' members and high-ranking executives.
- Performance evaluation of the different managerial levels in HCs and proposing their reward or censure.
- Reviewing and commenting on the business plans formulated by the HCs and monitoring their implementation. The business plans should include financial statements and a brief investment programme that has to be compared with actual performance, on quarterly and annual bases.
- Providing the PE Minister with a proposal of the guidelines to be used by HCs and ACs regarding the Government policy for business enterprise performance evaluation.

**C) Holding Companies (HCs)**

HCs are to initiate, administer and implement the privatization of the affiliated companies or their assets under the supervision of the PE Minister.

**D) Affiliated companies (ACs)**

ACs are to implement the plan. They may also sell or lease assets and productive units in the normal course of their business upon decisions of their Boards of Directors or General Assembly of stockholders. Managers and employees of ACs may, in certain cases, propose divestiture actions for their companies.

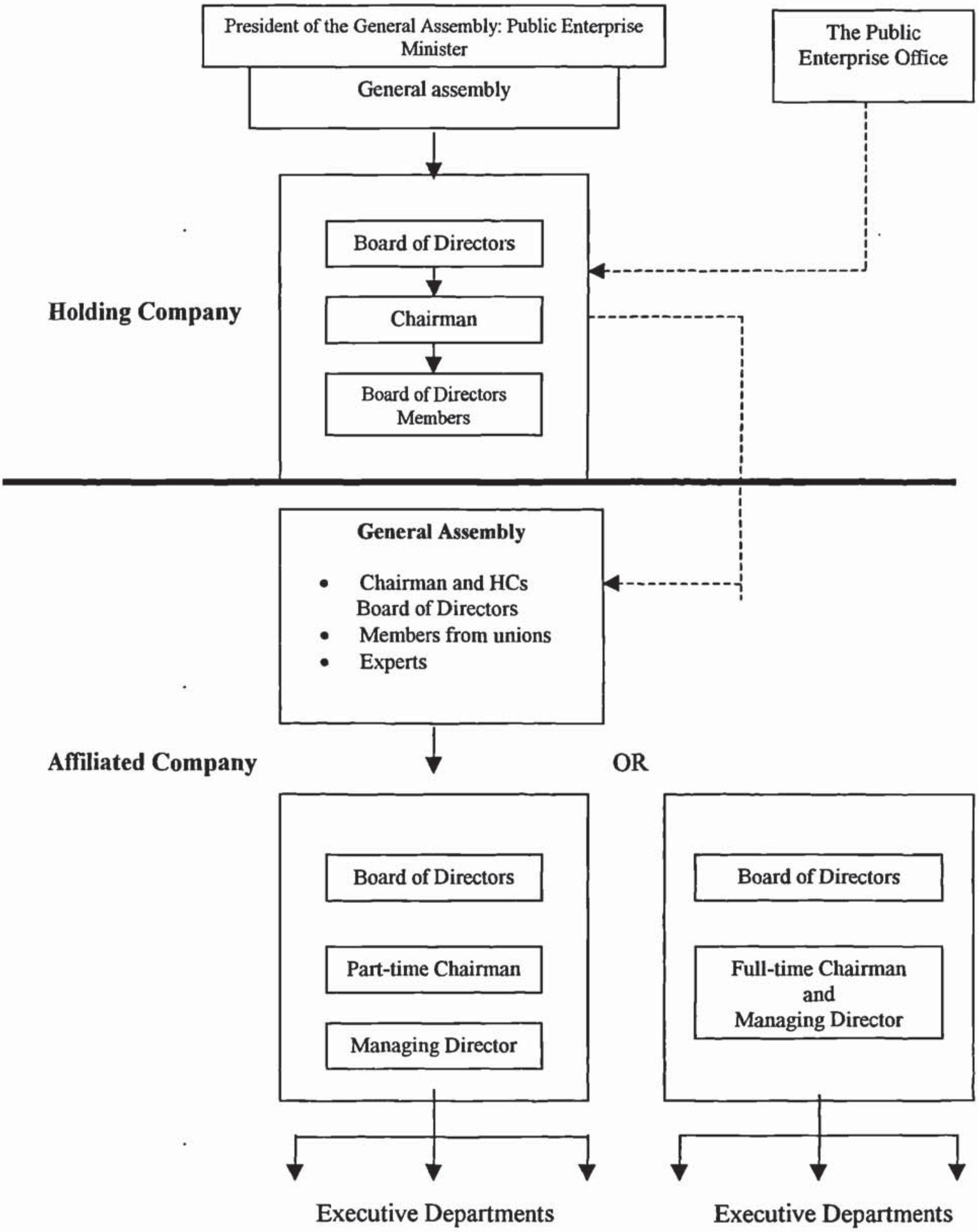
### 4.3.3 Ministerial Committee for Privatization

During the first quarter of 1996, the Prime Minister formed a Ministerial Committee for Privatization (IBTCI, March 1996). The committee's main task was to approve privatization plans, monitor implementation and report to the Cabinet. The Committee is chaired by the Prime Minister and includes the following members:

- Minister of Transportation.
- Minister of Public Enterprises.
- Minister of State for Follow up on Economic Activities.
- Minister of State for Planning.
- Minister of Health and Population.
- Minister of Electricity.
- Minister of Labour.
- Minister of Industry.

The Minister of Public Enterprises acts as a link between the holding companies and the Ministerial Committee. He presents a weekly report to the Ministerial Committee including the latest progress in the privatization programme, based on reports prepared by the HCs. The Ministerial Committee's responsibility is to monitor the GOE privatization programme and report developments to the Cabinet.

**Figure 4.1: Organizational and Communication Relationships among the Different Parties in the System**




*Source*: Al-Henawy, Mohamed Salah, Maher, Ahmed Mostafa, Effective Board of Advisors under the Umbrella of the New Law 203/1991, Public Enterprise Office, Technical Office, Eastern Advertising Publishing Company, 1993.

## 4.3.4 Major Principles Guiding the Privatization Programme in Egypt

### 4.3.4.1 Principles

The Minister of Public Enterprises and the PEO have announced several principles (Al-Henawy et al, 1993) governing the Privatization Programme in Egypt:

- The Privatization Programme is a market-driven programme aiming to stimulate demand for Government-owned enterprises and assets. Its main goal is to promote rapid, successful implementation of privatization. This is to be achieved by offering a variety of assets and decentralizing the responsibility for initiating and executing specific transactions.
- The programme covers a wide range of Government assets. It includes assets of local Governorates, all Government-owned and controlled shares in joint venture companies established earlier under Laws 43 and 230 and public enterprises operating under Law 203 except those in strategic sectors. It also includes Government-owned shares in corporations working under Law 159/1981.
- The programme encourages the transfer of assets to private owners with demonstrated technical know-how, operating expertise, management competence and financial strength. The programme also encourages broader individual and institutional share ownership.
- Clarity and transparency characterize the privatization process. Procedures to ensure this include notification that assets are available for divestiture, disclosure of financial and operating information, receipt and review of offers and their negotiation when necessary.

The following section illustrates a group of guidelines the GOE set for the privatization candidate selection process.

### 4.3.4.2 Selection of Privatization Candidates

Companies are selected for privatization in two corrective steps (Public Enterprise Office, 1994).

- First, individual affiliated companies are selected by their respective holding companies as part of the annual process of preparing a business plan, which is supervised by the PEO.
- Second, the PEO presents the list of selected ACs to the PE Minister for approval, prior to presenting it to the Boards of Directors and the General Assemblies of the HCs.

Candidates for privatization in the first few years of the privatization programme were chosen making sure that they cause minimum economic disruption. The GOE announced the following criteria for candidate selection (Public Enterprise Office, 1994):

- Profitable, medium-sized enterprises or business units, operating in competitive business sectors, which do not need financial restructuring, additional investment, operational reorganization, legal restructuring or significant corrective environmental measures.
- Economic, financial and commercial viability: Selected companies are expected to have a positive cash flow, viable current ratio and the liquidity ratio must indicate a positive long-term trend.
- Rates of return on assets and equity and profit margins must be attractive to the private sector. Debt and debt-to-equity ratios must be low to allow for easy privatization. Activity ratios against dumping and unfair trade practices, such as inventory turnover and accounts receivable collection periods or a joint team from both inside and outside the company must testify efficient enterprise operation.
- Operating in a relatively undistorted or easily correctable business environment where there is private sector competition and no monopoly or oligopoly.
- No protection currently or expected in the future will be granted to business enterprises.
- A minimal number of redundant employees.

## 4.3.5 The Privatization Process

The PEO announced that the privatization process consists of three distinct phases (Al-Henawy et al, 1993):

- Preparation and Evaluation of SOEs.
- Decision- making.
- Implementation.

These three phases are described below.

### 4.3.5.1 The preparation / Evaluation Phase Consists of the Following

This phase covers several tasks:

- HCs' preparation of the annual privatization programme as part of their annual business plan.
- The Public Enterprise Minister approving and selecting the appropriate privatization candidates.
- The HC / AC Board appointment of an individual or a team of individuals to be responsible for management of the entire privatization process. (The selected team must consist of individuals with recognized experience).
- In case of selecting a loss-making company, cancellation or conversion of debt into equity, consolidation and debt restructuring procedures are used to prepare the entity for sale.
- HCs and ACs submit applications to the PEO for technical assistance. The PEO Director studies and approves these applications. External consultants are then hired using multi-transaction contracts specifying the exact services and time limit for each transaction. These details added to payment procedures are also included in a Memorandum of Understanding between the PEO and the relevant HC or AC.
- Consultants undertake valuation of each privatization candidate company's assets and liabilities and an evaluation of its operating and financial performance. They recommend a sales strategy, including a target or reserve price in the event of a public offering or auction, or an offering

price in case of a share offer. A copy is sent to the PEO for follow-up and possibly comment.

- The consultants then present a written report stating the strategy recommended during the privatization implementation stage. This document verifies to the PEO and to the HC and AC that the analysis is thorough and complete. It is then considered the basis for the privatization transaction and is included in the offering as an information memorandum.

#### 4.3.5.2 The Decision-Making Phase

The Privatization Committee then reviews the consultant's report, and submits it to the PEO which includes its recommendations and gives it to the HC or AC decision-makers. The HC or AC decision-makers then decides whether or not to sell the asset or company, select a sales strategy and advise the Privatization Committee to start sales procedures.

#### 4.3.5.3 The Implementation Phase

After the decision to 'go ahead' has been taken, consultants proceed with support activities within the implementation phase of their contracts. Assistance with implementation includes preparing a sales prospectus, offering bid documents (memorandum), underwriting arrangements, evaluation of buyer's offers and negotiation assistance. HCs and ACs then start marketing the target candidates[3].

After the sale has been concluded, the PE Minister publicly announces completion of the sale and the assigned firm or consulting firm prepares a ***"White Book"***. The book contains all the official documents related to each stage of the process. It is sent to the HC, the AC, the Central Audit Organization, the Parliament and a copy will be kept at the PEO. The "***White Book***" is a public document.

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[3]Prior to selling the company or asset, the HC/AC usually solves any financial problems or makes arrangements for restructuring. In some cases the decision-making body may prefer to sell the entity "as it is".

The purchaser has to perform a *"Due Diligence Audit"* within a period of six months after closing the deal and acquisition of the assets. The audit must cover any new physical and intangible assets that were not included in the transaction and any new liabilities that were overlooked in the evaluation process. The purchaser then submits his claim to the PEO and the HC or AC.

### 4.3.6 The Privatization Committee Tasks

The Privatization Committee tasks are:

- Recommending the "offering price" of shares to HC or AC management. This is guided by the consultant's valuation of the company and his recommended price.
- Recommending a " target price" in the case of a tender sale or public auction.
- Managing the opening of sealed bids on assets in the presence of all bidders and then examining and evaluating the bids received.
- Negotiating the sale on behalf of the HC or AC including the evaluation results and the terms of sale.

### 4.3.7 Sales Proceeds

Sales proceeds for each transaction are deposited in separate interest-bearing accounts at the Central Bank of Egypt or one of the public sector banks, under the direct supervision of the Public Enterprise. The proceeds are partly used to repay the companies' debts to the banks and to finance the restructuring of the companies before their divestiture. The remainder is transferred to the Treasury. Disbursement of such accounts and the policy regarding the utilization of sales proceeds are decided by the General Assembly of the HCs, chaired by the PE Minister.

### 4.3.8 Comments on the Privatization Structure

As evident from the above structure and procedures the task of planning the privatization policy and the different programmes is a joint responsibility between the Ministerial level and the executives of HCs and ACs. The specific programmes are proposed by the executives of the HCs and ACs together with the PEO and approved by the Minister. This procedure is meant to ensure adequacy of the programme (being prepared at the implementation level) and its feasibility (being approved at the Ministerial level supposedly aware of the economic conditions and Government priorities). It also means that genuine desirability of the programme among both levels is guaranteed. For the Minister, privatization is a Government policy that he should support even if he believes otherwise. Yet, he has to actually feel that the Government is truly committed to the privatization policy in order to act accordingly. Degree of genuine Government commitment is one of the questions this study investigates. The Egyptian structure as such also gives HC and AC executives a large role in choosing candidates for privatization and planning for implementation and later executing plans. This study raises the question as to whether they truly desire privatization especially since their careers might be jeopardized by it.

The official Government privatization process is also characterized by long procedures. The many steps associated with the process and their distribution among different levels in the structure with several necessary reports being prepared and moved from the implementation level to the policy level and back cause slowness and delay. The numerous levels being involved in the planning and implementation phases make responsibility for delay rather vague.

The Public Enterprise Office serves as the main communication link between the different companies and the Minister. Although this link helps, it is not sufficient. A clear, completely developed network needs to be in charge of communicating the different changes and procedures to all levels. Clarity helps increase desirability at the different levels making specific programmes more feasible. Leaving space for unofficial communication increases rumours and could create resistance groups that hinder smooth implementation.

According to the 'good' practice model presented in Chapter Three, developing a clear monitoring system provided by feedback information from different levels is essential for privatization success. In Egypt, there is no clear system or structure in charge of monitoring actual implementation whether at the industry level or at the enterprise level. A Ministerial Privatization Committee was formed in 1996 to monitor the whole programme, at the policy level, but this committee would need monitoring data from the industry and enterprise levels. Considering the heavy ministerial duties, a specialized body for monitoring could well be more effective. Close monitoring is essential at both levels, the industry and enterprise levels, to detect any problem promptly and to report it to the policy level to develop ways of overcoming it or to change the programme accordingly. A clear monitoring structure with a clear system, organization and determination of responsibilities is recommended.

There is also no clear-cut structure in charge of marketing the privatization policy and programmes. Building public awareness is mentioned and support is mentioned as one of the tasks of the Public Enterprise Minister but the main body in charge is not mentioned. A specialized structure should develop a comprehensive marketing plan that takes into account the purchaser's ability to pay and interest to buy in determining which markets to pursue (whether local or international markets), what price to charge (e.g. real prices, reduced prices...etc.), how the promotional plan could help open new markets and which SOEs to start with. Marketing efforts are currently loosely carried out separately at different levels without a comprehensive approach.

Developing a comprehensive marketing plan is another prerequisite of successful implementation of privatization as shown in the previously mentioned model. As evident from the Government privatization process and structure marketing usually starts at the implementation stage. Most of it is limited to advertising for units offered for sale. Pricing is based on a case-by-case strategy. Local markets are reached efficiently, but a great deal remains to be done to reach wider international markets. Marketing efforts should be equally directed to promoting the idea of privatization in general and to promoting the planned programme, and promoting specific units for sale.

Most of the announced implementation procedures are related to procedures of private sales. Rules for sales through IPOs are not as detailed, although they have been much more frequent in the past decade.

These shortcomings are bound to decrease feasibility of the different programmes and definitely slow the rate of implementation. They might lead to:

- creating doubts about the programme and the Government intentions;
- slowing down implementation of the programme;
- failure to reach international markets; and
- vague responsibility and lack of accountability for the delay in the programme.

However the rate of implementation of privatization during the few years following the change of the law and the establishment of the structure are the main criteria to assess the extent of success of the new policies and structure. This is why the rest of the chapter is devoted to studying the actual rate of implementation of privatization during the period 1991 up till the year 2000.

## 4.4 The First Privatization Programme

The Privatization Committee announced the first privatization plan in 1991. The programme was to be implemented in the Public Enterprise companies operating under Law 203/1991 and the joint venture companies operating under Law 43/230 (in which the private sector already had a stake). The initial programme consisted of a targeted number of at least 25 candidates to be offered for sale in each of the years between 1991/92 and 1995/96. The candidates for the privatization programme consisted of companies, major assets or major production units of affiliated companies under the control of the 27 holding companies owned by the Government. At least 10 companies were wholly owned by the Government, Law 203 companies (PEO, 1994). The Programme also contained joint venture companies and companies with stock in the market (companies working under Law 159, governing corporations).

A more precise three-phase Privatization Programme was announced later in the same year (PEO, 1994). The new programme consisted of 20 candidates to be privatized in the Financial Year (FY) 1991/92, 25 candidates in FY 1992/93 and another 40 candidates to be privatized in the FY 1993/94. These candidates were chosen from a broad range of economic sectors. Details of this programme are shown in table 4.1.

**Table 4.1: The First Privatization Programme**

| | First Batch of Privatization Candidates FY 1991/ 1992 | Second Batch of Privatization Candidates FY 1992/1993 | Third Batch of Privatization Candidates FY 1993/ 1994 |
|---|---|---|---|
| **A. Law 203 Companies (100% State** | 1. Misr free shops Co.<br>2. Egyptian Vineyards Co.<br>3. El Nasr Bottling Co. | 1. Kafr ElZayat Insecticides & Chemicals Co.<br>2. The Nile General | • **Industrial Sector**<br>1. EL Nasr Co. for Refrac. & Ceramics (SORNAGA) |

| | | | |
|---|---|---|---|
| **ownership)** | 4. Egyptian Bottling Co.<br>5. El Nasr Glass & Crystal Co.<br>6. Misr Studio & film production Co.<br>7. El Nasr Steam Boiler Manufacturing Co. | Auto Repairs Co.<br>3. Arab Office Engineering Consultancy & Designs.<br>4. Paints and Chemical Industries Co.<br>5. Alexandria Co. for Pharmaceutical & Chemical Industries<br>6. El Nasr Engineering & Refrigeration Co. " KOLDAIR "<br>7. Egyptian Ship building & Repairs Co. | 2. Egyptian Copper Factory Co.<br>3. Industrial Gases Co.<br>4. Abuqir Fertilizer & Chemical Industries<br>5. Delta Spinning & Weaving Co.<br>6. Uniarab Spinning & Weaving<br>7. Dakahlia Spinning & Weaving<br>8. Damietta Spinning & Weaving<br>9. Alexandria Spinning & Weaving<br>10. Extracted Oil Co.<br>11. Tanta Oil & Soap Co.<br>12. Cairo Oil & Soap Co.<br>13. Oil & Soap Co.<br>14. Alexandria Confectionery & Chocolate Co.<br>15. Egyptian Starch, Yeast & Detergents Co.<br>16. Edfina Co. for Preserved Foods<br>17. Al Ahram for Beverages<br>18. Egyptian Light Transport Manufacturing Co.<br>19. Springs & Transport Needs Manufacturing<br>20. Misr Engineering & Tool Co.(MICAR)<br>21. Egyptian Co. for Refractors<br>• **Health Sector**<br>22. Medical Packing Co.<br>23. Arab Drug Company (ADCO)<br>• **Cement Sector**<br>24. El Ameria Cement Co.<br>25. Tourah Portland Cement |

| | | | |
|---|---|---|---|
| | | | 26. Helwan Portland Cement Co.<br>• **Foreign Trade Sector**<br>27. Misr Car Trading Co.<br>• **Domestic Trade & Distribution Sector**<br>28. Egyptian Co. for Wholesale Trade<br>29. Egyptian Co. for Fish Marketing<br>30. Egyptian Co. for Packing & Distributing Foodstuff<br>• **Housing Sector**<br>31. Development & Popular Houses Co.<br>• **Transport Sector**<br>32. United Arab Stevedoring Co.<br>33. Alexandria Containers Handling Co.<br>34. Port Said Containers Handling Co.<br>35. Damietta Containers Handling Co.<br>36. Egyptian General Warehouses<br>• **Tourism Sector**<br>37. Misr Hotels Co |
| **B. Assets of Law 203 Companies** | 8. Cairo Sheraton Hotel<br>9. Aswan Oberoi Hotel<br>10.Sheraton Boat M/S Anni<br>11.Sheraton Boat M/S Hotp<br>12. Sheraton Boat M/S Tut<br>13. Sheraton Boat M/S Aton<br>14. Shepherds Hotel | 8. Alamien Hotel<br>9. Palestine Hotel<br>10. Consumption Goods and Cloth " Sednawi"<br>1 1. Consumption Goods and Cloth " Secural "<br>I 2. Fashion Ware Home " Hano Alex "<br>1 3. Fashion Ware Home " Shamla " | • **Industrial Sector**<br>38. Delta Industrial Co. (IDEAL) (ALMAZA PLANT)<br>• **Tourism Sector**<br>39. Egyptian Hotels (Cissel Hotel)<br>• **Retail Trade Sector**<br>40. Consumption Goods & Clothes Co. (SEDNAWI) (BRANCH) |

| | | | |
|---|---|---|---|
| **C. Shares in Law 203 Companies** | 15. Porcelain Dinner-Ware & Utility Ware | 14. El Nasr Clothing & Textile Co. " KABO"<br>15. Egyptian Food Co. " Bisco Misr "<br>16. Egyptian Supplies & Marine Works Co.<br>17. United Housing Co.<br>18. El Nasr Electronics & Eng. Co. " Philips " (White Goods Factory ) | |
| **D. Shares in Law 159 Companies** | 16. Misr Touristic Village Co. | | |
| **E. Shares in Law 230 Companies** | 17. Suez Cement Co.<br>18. Chloride Egypt<br>19. Ashti Co.<br>20. Egypt Narden International | 19. Egyptian International Pharmaceutical. Co. " EPICO"<br>20. Egyptian German Electrical products Co.<br>21. Schindler Egypt<br>22. Egyptian German Dyes Co.<br>23.Misr Carbonated Beverages, Misroub<br>24.Arabian Ceramic Co. "Aracmco"<br>25.Sinai Diving Club | |

*Source: Public Enterprise Office, General Procedures and Guidelines for the Government's Programme of Privatization, Restructuring and Reward System, 1994.*

As evident from table 4.1 the initial plan was to start by privatizing 20 companies in 1991/92. This number was to increase to the targeted number of 25 companies in the second batch and to an optimistic 45 in the third batch. One can also notice that only seven of the companies planned to be privatized in the first batch were fully owned by the Government. This number represents approximately 2% of the state owned companies and 0.003% of the total public sector assets. Similarly, only seven of the planned candidates in the second batch are fully Government owned. The rest of the candidates in both cases were either joint venture companies in which the private sector already had shares or corporations in which there was private share ownership. However the plan was to increase the number of fully owned companies to be privatized to 37 in the last batch (representing approximately 12% of the PEs and 1.8% of total public sector assets).

This *planned* slow launch of the programme could be interpreted in several ways. It could have been due to the Government's desire to prepare public opinion and the different stakeholders for the new policy. Another interpretation could be preparation of the public units and their employees for the change (Khatab, 1996). It could also be a time-buying method for political reasons. Time will show which of these interpretations was nearest to the truth.

### 4.4.1 Actual Implementation of the First Privatization Programme

Naturally, the next step after planning would be implementation. The following table shows how much of the initial, modest programme had been actually implemented by the end of 1995.

**Table 4.2: Number of Privatized Companies Classified by Method up to December 1995**

| Method | 1991 | 1992 | 1993 | 1994 | 1995 | Total |
|---|---|---|---|---|---|---|
| IPOs* | 0 | 0 | 0 | 0 | 0 | 0 |
| Liquidations** | 4 | 2 | 1 | 1 | 3 | 11 |
| ESAs*** | 0 | 0 | 0 | 9 | 0 | 9 |
| Anchor Investors | 0 | 0 | 0 | 3 | 0 | 3 |
| Total | 4 | 2 | 1 | 14 | 3 | 23 |
| Percentage of the Total (aprox) | 17 | 9 | 4 | 58 | 13 | 100% |

* IPOs: Initial Placement Offers
** Liquidations: When the decision of liquidation had been taken
*** ESAs: Employee Shareholders' Association
*Source:* Public Enterprise Office

The table shows:

- Actual implementation of the programme was very limited up till 1995. Only 23 companies out of the planned 90 companies were actually privatized.

- There were no IPOs during the first five years although selling stocks through the stock market had been announced as a main form of privatization aiming for a wider ownership base.
- The privatization activity during the first three years of the programme was limited to decisions to liquidate a total of seven loss-making companies (4, 2 and 1 companies in the years 91, 92 and 93 respectively).
- 1994 was the year during which most of the privatization activity took place. Shares of nine different companies were offered to the employees in Employee Shareholders' Association scheme (ESA). Three other companies[4] were sold to anchor investors and the thirteenth company was divested.
- Privatization activity slowed down again in 1995. The only activity was announcing the decision to liquidate three more companies.

The following table shows the change in private ownership in companies originating from Law 203 up till the end of 1995:

[4]The three companies are Pepsi Cola, Coca-Cola, and El-Nasr Boilers and Steam Vessel Manufacturing Company.

**Table 4.3: Number of Operating Companies Originating from Law 203 with Private Sector Share***

<table>
<tr><th colspan="2">%Privately Owned **</th><th>As of 12/31/93***</th><th>As of 12/31/94</th><th>As of 4/3/95</th><th>As of 7/31/95</th><th>As of 12/31/95</th></tr>
<tr><td colspan="2">100%</td><td></td><td>3</td><td>3</td><td>3</td><td>3</td></tr>
<tr><td colspan="2">>75%<100%</td><td></td><td>11****</td><td>11</td><td>11</td><td>11</td></tr>
<tr><td colspan="2">>50%up to 75%</td><td>1</td><td>1</td><td>1</td><td>1</td><td>1</td></tr>
<tr><td colspan="2">Subtotal (Majority Private)</td><td>1</td><td>15</td><td>15</td><td>15</td><td>15</td></tr>
<tr><td colspan="2">>40% up to 50%</td><td>3</td><td>5</td><td>5</td><td>5</td><td>5</td></tr>
<tr><td colspan="2">>30% up to 40%</td><td>4</td><td>5</td><td>7</td><td>7</td><td>7</td></tr>
<tr><td colspan="2">>20% up to 30%</td><td>5</td><td>6</td><td>6</td><td>7</td><td>8</td></tr>
<tr><td colspan="2">>10% up to 20%</td><td>2</td><td>3</td><td>3</td><td>6</td><td>6</td></tr>
<tr><td colspan="2">> 0% up to 10%</td><td>17</td><td>17</td><td>17</td><td>17</td><td>17</td></tr>
<tr><td colspan="2">Subtotal (Minority Private)</td><td>31</td><td>36</td><td>38</td><td>42</td><td>43</td></tr>
<tr><td rowspan="2">Liquidations</td><td>Actual</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>In progress</td><td></td><td></td><td>(10)</td><td>(10)</td><td>(10)</td></tr>
<tr><td colspan="2">Mergers</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="2">Subtotal (Fully Public Companies)</td><td>282</td><td>264</td><td>262</td><td>258</td><td>257</td></tr>
<tr><td colspan="2">Number of Operating Companies</td><td>314</td><td>315</td><td>315</td><td>315</td><td>315</td></tr>
</table>

* Includes separately sold assets, which are formed into new companies

** Private ownership includes shares owned by employees and ESA's

*** The private sector's ownership interest in the 32 companies reported in this column was present before the start of the current privatization programme

**** Includes Cairo Sheraton Hotel (spin-off)

*Source:* International Business & Technical Consultants, Inc., IBTCI Quarterly Report: January-March, 1996.

It is evident from the above table that:

- No Change in ownership occurred during 1991,1992 and 1993 (see note*** in table 4.3.
- In 1994, three companies were sold to anchor investors (100% ownership). During the same year, majority private interest also increased due to the sale of eleven companies to ESA, and the Spin-off Company Cairo Sheraton Hotel.
- Minority interest increased in five companies during 1994 and in seven companies in 1995.
- Up till the end of 1995 the ten liquidations were not yet finalized.

**Table 4.4: Value of Unutilized Assets Sold as of December 1996**

*(LE million)*

| **Year** | **1992** | **1993** | **1994** | **1995** | **1996** | **Total sales** |
|---|---|---|---|---|---|---|
| **Sales** | 545.86 | 322.25 | 744.14 | 1397.25 | 23.55 | 3033.05 |

***Source: Public Enterprise Office, 1997***

This table shows that a lot of unutilized assets have been sold since the beginning of the programme, especially in the year 1995 when most sales took place. This accounts for the numerous announcements by the Government of actual sales taking place.

Looking at the four tables above the following can be inferred:

- Actual implementation of the privatization programme was very limited and very slow compared to the plan
- Besides the ESA privatization, the increase in privately owned shares in Public Enterprises was limited to purchases of stock of secondary floatation of PEs that already had stock in the market.
    - Only three companies were sold to anchor investors.
    - The rest of the activity was sales of unutilized assets.
- Even if the entire plan had been implemented the size of the privatized units would have been low compared to the size of the public sector (since the 315 PEs represent only 15% of total public sector assets in Egypt).

Many reasons could explain this slowness in implementing privatization. It could be a result of lack of firmness and strictness in the Government privatization policy. It could be due to problems in the implementation stage. It could also be a result of the decision-maker being not really dedicated to privatization. In this latter case the delay might well be a time-buying tactic. Or it could have been simply a necessary period for the technical and legal preparatory phase to be completed.

## 4.5 Privatization Activity in 1996

In an effort to activate the privatization programme the Cabinet approved several decisions concerning the Stock Market, foreign investments, Banking Lawand Investment Funds during 1994 and 1995 (O' Farrell, 1995). This positively affected the pace of the programme. While the start up of the privatization programme was slow, the progress made during 1996 was substantial. One could safely say that 1996 was not only a turning point in the Egyptian privatization activity but it was also the most active privatization year during the last decade. During that year Egypt was able to attain many of its reform and privatization objectives. According to the Director of the PEO (Interview, 1995) the relatively cautious pace of privatization has allowed the development of Egypt's capital market institutions, created a new financial services industry and provided time for the Government's regulatory and oversight mechanisms to keep up with a rapidly expanding market.

The increased pace of privatization started with by President Mobarak's announcement that acceleration of the privatization programme was necessary (Al Ahram newspaper, 23rd January, 1996). This was followed by the Cabinet's approval of a more aggressive plan, prepared by the PE Minister and announced in February (Al Ahram newspaper, 15th Feb., 1996). The PEO then issued a new version of the General Procedures and Guidelines of the Government Programme for Restructuring and Reward System. This was an official document shedding light on the programme, its achievements and details of future plans.

During the first few months, there were no actual sales of shares or companies. It was considered a preparatory period for the coming activity. The month of May marked the "threshold of the Egyptian privatization program"(International Business &

Technical Consultants Inc. (IBTCI), October-December, 1996). Before May, the GOE's privatization programme took the form of limited Initial Public Offerings (IPOs) and a few anchor sales. This policy was abandoned beginning early May, where two companies, Madinet Nasr Construction Co. and Egyptian Financial & Industrial Co., were 75% privatized via IPOs in the stock market, transforming them to joint venture companies governed by Law 159. In the next few months more companies were offered through stock market floatations totaling 20 companies by the end of the year. In the second half of 1996 three companies were privatized through anchor (sole) investors. These companies are Almaco, Al-Ahram Beverages, and Nasr Public Utilities & Installation Sales. One company was liquidated and 13 joint venture banks were also sold during that period. Many analysts consider these offers indicative of the seriousness of GOE in its privatization efforts and the credibility of its early commitment to privatization (IBTCI, May, 1996).

The total number of companies that were privatized during 1996 is 28 of which 20 were sold through IPOs. However the total number privatized by the end of 1996 was 51 Law 203 companies and 13 joint venture banks. Total value of these transactions exceeded LE 10 billion (IBTCI, October-December, 1996). Table 4.5 shows the number of companies that were privatized during the period 1991-1995 and the companies that were privatized in 1996 illustrating the privatization methods used.

**Table 4.5: Number of Privatized Companies as of December 1996**

| Method | 1991-1995 | 1996 | Total |
|---|---|---|---|
| **IPOs** | - | 20 | 20 |
| **Liquidations** | 11 | 5 | 16 |
| **ESAs** | 10 | - | 9 |
| **Anchor Investors** | 3 | 3 | 6 |
| **Total** | **23** | **28** | **51** |
| **Percentage of the Total** | 45% | 55% | 100% |

*Source: Public Enterprise Office*

Looking at the above table one notices that:

- While most of the privatization activity before 1996 was limited to liquidations and ESA sales the picture changed in 1996 which witnessed all the IPOs.

* Also, the number of companies actually sold to anchor investors in 1996 equals the number sold in the previous five years.

However, even though Egypt's privatization performance during 1996, was quite satisfactory, it still did not meet its quantifiable objectives for the year. To illustrate this the researcher has taken the last quarter of 1996 as an example.

**Table 4.6: Comparison between Planned and Actual Privatization During the Last Quarter of 1996**

| Holding Company | Affiliated Company Planned to be privatized | Company Status |
|---|---|---|
| Chemical Industries | Industrial Gases | Not Privatized |
| | Paints & Chemicals | Not Privatized |
| Food Industry | Egyptian Foods | Not Privatized |
| Housing, Tourism & Cinema | Alhram for Beverages | Privatized |
| | Misr Free Shops | Not Privatized |
| Metallurgical Industries | Ameriya Cement | Privatized |
| Engineering Industries | Egypt Electro Cables | Not Privatized |
| Inland Transport | Damietta Cargo & Container Handles | Not Privatized |
| Maritime Transport | Egypt Gn'l Warehouses | Not Privatized |
| National Construction | Misr El Geuedida Housing & Development | Not Privatized |
| | Nasr Public Utilities & Installation (Offered in Sept. 1996) | Privatized |
| Housing, Tourism & Cinema | Cairo Sheraton (Offered in 1993) | Privatized |
| Mining & Refractories | Helwan Cement (planned for 1997) | Privatized |

*Source: PEO., compilation and presentation by IBTC, October- December Quarterly Report*

Looking at the above table one notices that:

* Out of the 13 companies that the GOE had planned to privatize in the last quarter of 1996, only five privatization transactions actually took place.
* Out of the five transactions that took place one was offered since 1993 and another was planned for 1997.

Again, the performance in 1996 raises questions about how firm the programme is.

## 4.6 Privatization Activity in the Year 1997

Privatization activity during the first half of 1997 was rather significant, yet it slowed down again during the rest of the year. Table 4.7 summarizes the progress.

**Table 4.7: Planned and Actual Privatization in 1997 (broken down by method)**

| Method | Planned No. of companies to be privatized during 1997 | No. of companies actually privatized in each quarter | | | | Total | % of actual/ planned[5] |
|---|---|---|---|---|---|---|---|
| | | 1st | 2nd | 3rd | ٤th | | |
| **Majority IPOs*** | 18 | 1 | 5 | 2 | 5 | 13 | 72 |
| **Liquidation** | 14 | 3 | 4 | | | 7 | 50 |
| **ESAs** | | | 3 | | 2 | 5** | Unplanned |
| **Anchor Investors** | 33 | | | | 2 | 2*** | 6 |
| **Total** | 65 | 4 | 12 | 2 | 9 | 27**** | 42 |

** Includes 6 companies which had private ownership of 40%, and twelve companies in which the private sector already held a majority.*
*** ESAs that took place were not previously planned. They were offered later according to a Cabinet decision.*
**** The decision to sell El-Naser and Ideal Companies was taken in the first quarter but actual steps started in December.*
*****The number includes the unplanned 5 companies privatized through ESAs but does not include the minor tranches offered in the stock market in three different companies. A decision to sell tranches in a fourth company was also taken in December, but actual offer happened in January 1998 (the delay was due to a decrease in International Aluminium prices which forced the Cabinet to postpone the offer of Misr Aluminium Company.)*
*Source: PEO, Compilation and presentation by researcher.*

The previous table shows:

- Most of the privatization activity took place during the first half of 1997 (17 cases). There were only two privatizations during the third quarter and nine during the fourth quarter.
- The planned privatization activity concentrated on anchor investor sales (33 planned companies), but only two sales were actually made, which indicates problems impeding implementation.

[5] Approximation to the nearest percentage was used.

- Five cases out of the 27 privatized companies were unplanned ESA sales. If we exclude them and compare the plan to actual implementation, the percentage falls from 40 % to 30%.

## 4.7 Privatization Activity in the years 1998 and 1999

A substantial drop in the number of companies offered for sale through share flotations characterized the last two years of the previous decade. Contrary to the impressive stock flotation activity in both 1996 and 1997 the number of companies offered through this method was only four in 1998 and none in 1999 (table 4.8). This was accompanied by an increase in Government dependence on other methods of privatization e.g. ESAs in 1998 and sales to anchor investors in 1999.

**Table 4.8: Privatization Activity in the years 1998 and 1999**

| **Total** | **1998** | | **1999** | | **Total** |
|---|---|---|---|---|---|
| **Method** | **No.** | **%** | **No.** | **%** | **No.** |
| **IPOs** | 4 | 19 | 0 | 0 | 4 |
| **Liquidations** | 4 | 19 | 0 | 0 | 4 |
| **ESAs** | 11 | 52 | 4 | 36 | 15 |
| **Anchor Investors** | 2 | 10 | 9 | 69 | 11 |
| **Total** | **21** | **100** | **13** | **100** | **33** |

*Source: Public Enterprise Office*

As in previous years, actual privatization activity in 1998 and 1999 was very different from set plans. According to a senior member of staff at the PEO there were more than ten different plans during those two years (Interviews at PEO, January 2000). When asked how much of each plan was implemented, he answered that implementation was not finalized in any of them, rather it was a flexible process in which companies were rescheduled according to circumstances. He mentioned the 82, 55, 68 and 74 company plans but percentage of implementation did not exceed 20% in any of them.

## 4.8 How Much of the Official Announcements Actually Materialized?

Not only has actual implementation of official programmes been rather slow, but also official statements of Government officials were very far from actual implementation. Ironically, one official once joked that if every company announced was sold the whole country would have been sold (IBTCI, May 1996). Two examples are cited below.

In December 1996, President Mobarak (AlAhram newspaper, 15th December, 1996) assured the people that selling the GOE shares in joint venture companies was a priority of the programme. He stated that by the end of 1997 the GOE would sell its share in all the 134 joint venture companies in which it has shares. According to PEO officials none of them were actually sold. In fact, given the managerial methods and procedures used, this target was nearly impossible. Below is a summary of Government ownership in joint venture companies at the end of 1996 and that at the end of 1997. As evident, not a single change took place.

**Table 4.9: Joint Venture Companies under Law 203 Participation in 1996 and 1997**

| Holding Company | Companies with Law 203 Participation (shares) at the end of 1996 | | | Companies with Law 203 Participation (shares) at the end of 1997 | | |
|---|---|---|---|---|---|---|
| | No. Of JVC. | % of total | Value of Ownership | No. Of JVC. | % of total | Value of Ownership |
| Food Industries | 9 | 6.72% | 46 | 9 | 6.72% | 46 |
| Engineering Industries | 13 | 9.70% | 101 | 13 | 9.70% | 101 |
| Pharmaceutical & Medical Appliances | 8 | 5.97% | 35 | 8 | 5.97% | 35 |
| Chemical Industries | 7 | 5.22% | 27 | 7 | 5.22% | 27 |
| National Construction | 9 | 6.72% | 52 | 9 | 6.72% | 52 |
| Construction & Electricity Distribution | 6 | 4.48% | 20 | 6 | 4.48% | 20 |
| Mining and Refractors | 8 | 5.97% | 65 | 8 | 5.97% | 65 |
| Metallurgical Industries | 7 | 5.22% | 74 | 7 | 5.22% | 74 |
| Inland Transport | 7 | 5.22% | 89 | 7 | 5.22% | 89 |
| Textile Manufacturing & Trade | 5 | 3.73% | 21 | 5 | 3.73% | 21 |
| Cotton & Foreign Trade | 7 | 5.22% | 4 | 7 | 5.22% | 4 |
| Spinning & Weaving | 2 | 1.49% | 4 | 2 | 1.49% | 4 |
| Maritime Transport | 3 | 2.24% | 289 | 3 | 2.24% | 289 |
| Housing, Tourism & Cinema | 40 | 29.85% | NA. | 40 | 29.85% | NA. |
| Flour Mills | 3 | 2.24% | NA. | 3 | 2.24% | NA. |
| Total | 134 | 100% | | 134 | | |

*Source: The 1996 data from IBTCI Quarterly Review for October-December31, 1996, and the 1997 data from the PEO*

Another significant incident was the PE Minister's announcement at the Paris conference held in May 1997 that the Government would privatize 51 companies and banks with a total value of LE 8.9 billion in the period between May and June (Table 4.9). *Again if this number is compared with the total number of privatizations since the* beginning of the programme one could easily suspect little chances of fulfillment. It is worth mentioning that the total number of privatizations since the beginning of the programme between June 1991 and April 1997 reached only 46 companies including ESAs, anchor investor sales, IPOs and liquidations (IBTCI, January-March, 1998).

**Table 4.10: Privatization Plan for the Period from May 1997 to July 1997[6] Compared to Actual Implementation in the Same Period**

| Offering Method | Planned Companies/Banks | | | Actual | |
|---|---|---|---|---|---|
| | No. | Value in millions | % of total | No. | % of planned |
| Sales through GDR | 3 | 1847 | 20.66% | 0 | 0 |
| Sales through Stock Market | 16 | 1263 | 14.12% | 5 | 31% |
| Sales of Joint Venture Companies | 15 | 784 | 8.77% | 0 | 0 |
| Sales to Anchor Investors | 17 | 5048 | 56.45% | 0 | 0 |
| **Total** | **51** | **8942** | **100%** | **5** | **10%** |

*Source: PEO, tabulated and presented by researcher*

It is evident that there is a large discrepancy between officially announced targets and actual implementation although some of these announcements came from the highest levels of authority.

## 4.9 Privatization Objectives and Implementation: An Overall Assessment

To study how successful the programme in Egypt has been, actual implementation should also be compared to the objectives of the programme. Reviewing actual implementation shows that most objectives were not attained during the first five years of the programme. This slack pace accelerated during the second half of 1996 and the first half of 1997. Yet, starting from the second half of 1997 implementation tended to slow down again raising doubts about the future of the programme and whether it would keep its 1996 pace after 1997.

The GOE's declared aims for the privatization programme were (PEO, 1996):

1- Reducing the drain on fiscal resources and improving resource utilization.

[6] For interested readers details of names, share volumes, market value and the percentage that was to be sold of each company, the banks concerned and the different methods used are included in the IBTCI Semi-annual report for the period from January to June 1997.

2- Using the selling proceeds to cover public sector losses, restructuring and transferring the surplus to the Government budget resources.

3- Widening the private ownership base of enterprises.

4- Activating capital markets.

5- Securing enhanced access to foreign markets, technologies and capital.

6- Increasing job opportunities.

7- Improving efficiency in the use of state owned enterprise assets.

The following sections assess how far these aims were attained.

**4.9.1** The programme succeeded in reducing the drain on fiscal resources after 1996, to a certain extent, by using the proceeds to repay the affiliated companies' debts and to finance expansion plans which were in place prior to the initiation of the programme. The proceeds of the divestiture of joint venture banks were used to reduce contingent liability of State Banks. This was done by first transferring the proceeds to the Central Account and then allocating the money to the different uses. Yet, the objective of enhancing capital utilization and redirecting it to more beneficial uses was not very evident at this stage.

**4.9.2** The aim of widening the country's ownership base and ensuring widespread ownership by Egyptian citizens in financial assets was achieved in the financial year 1996/97 to a large extent. The GOE policy of allocating stock to individuals, employees and institutions succeeded in encouraging small investors to enter the stock market, creating a new trend of investment behaviour. These goals have also been assisted through share floatation that reserved partial allocations for small individual investors and the numerous precautions that the Government took to ensure that more small individual investors had a successful first experience with the securities industry.

**4.9.3** The Egyptian Capital Market was activated gradually during the first few years of programme implementation. For example, the number of brokerage firms grew from 13 in 1992 to over 119 in 1996. The number of banks involved in the securities industry has also increased. Mutual Funds, which were non-existent when the programme began, reached 13 in 1996 with several international country funds devoted solely to Egypt. Investment Funds were also created and a Clearance and Settlement System has been initiated to ensure that transactions occur smoothly. The stock market itself has been able to handle an influx of trading 10 times its normal level and its technological sophistication is improving continuously. In 1995, Egypt was the fastest growing stock market in the world with a 44% growth rate and in 1996 it may have been number one again with a 38% growth rate (IBTCI, January-March, 1998). Yet, stock market activity slowed down in 1998 and further still in 1999. This was mainly due to losses incurred by small inexperienced investors who were driven out of the market.

**4.9.4** The Government's aim to enhance access to foreign markets, technology and capital has also been reasonably attained through the development of capital markets. The ability of Egypt to attract foreign capital was greatly facilitated by the progress in privatization during 1996. Before 1996, the low national return on investments (less than 4% on invested capital), coupled with the inability to attract private sector capital into the markets (less than 1.4% of worldwide investments) was preventing Egypt from realizing a sufficient growth rate to absorb an expanding labor market. In 1996, according to the Minister of Finance, Egypt recorded a 400% increase in Foreign Direct Investment. In addition, IBTCI has documented inflows of at least $750 million in Foreign Portfolio Investment. This, coupled with an outpouring of local capital, is increasing Egypt's potential to expand GDP at a faster rate.

**4.9.5** The Government' objective of creating new job opportunities still remains unattained to a large extent. Although the growth of the stock market industry succeeded in creating employment and careers at the middle management level, this was not the case for the rest of the employment levels. The money invested in the market through privatization was, in most cases, utilized to cover past debts of SOEs rather than to establish new projects or to expand old ones and create new job opportunities. At the same time, the capital gains realized by investors in the Stock Market were in many cases re-invested again in the Stock Market to make more gains.

**4.9.6** The aim of improving efficiency in state-owned assets remains to be seen. Although implementation of the programme was best in 1996, this seems to have had a negative effect on SOEs' performance (see Chapter Seven).

**4.9.7** Finally, Egypt's progress in its structural adjustment programme, debt reduction, investment incentives, and trade liberalization has allowed it to obtain a BBB- and A- sovereign debt rating from Standard and Poors[7]. These ratings have allowed Egypt to return to international capital markets and borrow, if necessary, at more reasonable rates. Egypt is also developing a new investment law, a new labor law, an anti-monopoly law and a bankruptcy law that will improve the investment climate. Such steps are intended to add to its ability to attract foreign capital.

## 4.10 More Views Regarding Privatization Activity

Since the start of the accelerated period of privatization in 1995, the GOE has mainly depended on IPOs in selling state-owned enterprises. This seemed to be the best choice in the early sensitive phase of launching privatization, since it was more appropriate for a period full of social and economic constraints especially that it raised much less criticism than other methods. It also served the GOE objective of widening the ownership base.

An Egyptian privatization analysis report (IBTCI, October-December, 1997) summarizes arguments for the continued GOE reliance on IPOs versus other methods of privatization in the following short-run economic and political benefits:

- Inexpensive for HCs;
- Little public information required;
- Sales often occur at prices substantially above book value;

- Process is less staff- intensive;
- Process is quicker;
- Less likely to incur criticism for selling too low;
- Contributes to the short term objective of widespread public ownership;
- More likely to delay the labour redundancy problem; and
- Public sector retains control of a large block of shares.

Selling through the stock market also has the advantage of maximizing GOE selling proceeds since IPOs tend to command premium prices on the stock exchange. It also has the advantage of generating income for several other financial institutions including brokerage firms, banks and mutual funds, which enhances the development of the financial market and increases employment in the sector.

However, since the stock market's turn down in February 1997 the pace of privatization has become slower. Investors, both domestic and foreign, are less likely to risk investments in new IPOs, particularly since Egypt's best profit making public sector companies have already been offered. Many of the remaining affiliated companies need serious financial restructuring before any attempt at offering them on the market can be safely pursued. The failed secondary offerings of Electric Cables and El Shams Housing, as well as the failed IPO of Wadi Cotton Ginning in 1999, demonstrate the difficulties of pursuing exclusively the IPO path towards privatization for companies lacking a sound base (IBTCI, October-December, 1997).

Another problem that faces this method of sale is the high expectations of the stock purchasers as a result of the dramatic increase in share values during 1996 and early 1997. Unfortunately, most of the remaining companies are not expected to make such high gains. The unsatisfied growth expectation will probably disappoint new market entrants causing further decline in the demand for stock.

The extent of success of future IPOs will depend on the positive performance of the stock market and the availability of profitable Law 203 companies. Although many analysts believe that the IPO approach may not be consistent with the long-term objective of integrating Egyptian industry into competitive global markets, it seems to be the most practical method of sale up to now.

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[7] An independent firm specialized in economic analysis and assessment. Its economic and credit worthiness assessments are internationally recognized.

Many analysts believe that concentrating on anchor sales[8] during the future period would be the best option (Refeat, 1997). Anchor sales could be much more appropriate for the longer-term objectives of creating and sustaining an industrial structure that would achieve and then maintain its competitiveness in global markets. Anchor sales would aim beyond maximizing the short-run financial return to the Government, to raising productivity and efficiency of SOEs. This will eventually create new higher-paying jobs, reduce labour redundancy, increase tax revenues and promote both higher and more diversified exports (Interviews with Stock Market Officials).

However this approach has encountered several difficulties during implementation in the past few years. This was noted from the relatively low number of candidates (21 companies, as of 31 December 1999), that were actually privatized through this method. The main problems facing this method have been set out below:

- The major obstacle for this method is the valuation problem (see Chapter Nine). Valuation of the privatization candidate represents the most sensitive issue that, in many cases, delays or even cancels anchor sales. There is always a fear of not setting a fair price or at least being accused of not doing so. In many cases the main disagreement between potential buyers and the GOE representatives, causing termination of the selling procedures was price differences. Potential buyers (especially foreigners) usually estimate a high risk factor for investing in the Egyptian market, hence lowering sale price. In most cases the selling committee does not agree. Substantial improvements in macroeconomic stability, economic growth, macro economic information, firm-specific data and increased activity of the stock market, leading to an improved business climate in Egypt could eventually make investors more secure.
- The internal management process of an anchor sale is rather complicated requiring many procedures and approvals. The sales process requires the involvement of many high level officials in many organizations (especially for approval of the valuation component). The process could be described as rather staff intensive, with many involved from the MPE / PEO and the holding company. This usually slows down the process, causing the overlooking of details and sometimes the insufficient attention to serious buyers.

[8]Selling to one or a few major investors.

- International marketing is essential to extend markets for privatization candidates worldwide. Unfortunately, holding companies and GOE representatives in charge of implementing anchor sales do not have a well-developed system for international marketing. In many cases they depend on contacting embassies[9] or on local sales agents who lack the experience and capabilities of international marketing linkages. A more sophisticated approach should be developed to study international markets, identify potential purchasers and develop new markets. Direct marketing efforts besides the help of the mass media should be able to bring good sale candidates to the attention of qualified and appropriate buyers.
- Short-term considerations of profit maximization by selling privatization candidates through the stock market are given higher priority than long term benefits an anchor investor could provide.

## 4.11 Privatization and Implementation: Benchmarking with the Good Practice Model

Since implementation of the programme is primarily a policy level decision, the following lines will use the steps in the "good" practice model as a checklist of the policy level role and whether it is adequately performed. The resulting comments are based on the comparison between plans and actual implementation presented earlier in this chapter in addition to material presented in previous chapters. Results of the comparison are summarized in table 4.11 preceded by a 'reminder' of the model at the policy level.

[9] In the 'Egyptian Company for Refractories' case mentioned in Chapter Six, the holding company contacted several embassies seeking buyers. The replies were filed for further contact if sale of the two plants was implemented.

## Reminder of the Policy level in the "Good Practice" Model

| Policy-level |
|---|
| Check whether privatization is actually desirable[10]<br>Develop a comprehensive programme of macro-reform<br>Develop a plan for the different stakeholders and resistance groups<br>Change laws and companies' systems to make them more suitable for the change<br>Develop an adequate, firm and strict programme of privatization<br>Develop a comprehensive plan for privatization<br>Create a structure with clear responsibility and authority for implementing the programme<br>Define responsibility levels of implementation clearly allowing for adequate accountability<br>Develop a clear monitoring system with required accountability procedures<br>Determine different methods of dealing with the management and work force<br>Develop a comprehensive marketing plan<br>Develop a mass-media-backing plan |

**Table 4.11: Comparison between Model Steps and Actual Performance**

| Model Steps | Comments on Actual Performance |
|---|---|
| Check whether privatization is really desirable | According to official announcements the answer to this question is in the affirmative. Yet according to the rate of implementation the answer seems doubtful. If privatization had been truly desired then the Government would have been much stricter about implementation. Also, even if all the programmes were actually implemented we are talking about a part of 15% of the total value of Government assets. In 1997 some talk has started around the other 85%, but nothing tangible has been done. |
| Develop and implement a comprehensive programme of macro-reform | Actually implemented with quite successful results (Chapter Two). |
| Develop a plan for the different stakeholders and resistance groups. | There is no evident plan other than slowing down implementation. |

[10]According to World Bank Report "Bureaucrats in Business", reform becomes desirable when its political benefits for leadership outweigh its political costs. This happens when those favouring continuation of SOEs lose power or when the problems of subsidizing SOEs become so costly that reform becomes preferable to their existence (Galal et al, 1985).

| | |
|---|---|
| Change Laws and companies' systems to make them more appropriate for the change | New laws were issued to govern Stock Market and SOEs. Other laws concerning labour and the financial market are still being developed. Adequacy and sufficiency of the present legal system will be discussed in a later chapter. |
| Develop a Comprehensive Plan for Privatization | A comprehensive plan for privatization was developed and announced in two booklets issued by the PEO in 1994 and 1996 consecutively. The plan included Government priorities, authorities and responsibilities, and expected timing. Possible problems, ways to tackle them and methods of monitoring the different plans were not included in the plan.<br>The Government decided to start by profitable, medium-sized enterprises or business units, operating in competitive business sectors, which do not need financial restructuring, additional investment, operational reorganization, legal restructuring or significant corrective environmental measures. These features characterized most of the companies that were actually sold. The only disadvantage of this strategy (of concentrating on more successful companies) is that most of the companies that are left unsold are the least attractive to the private sector, which makes one question the future of privatization. |
| Develop an adequate, firm and strict programme of privatization | Actual implementation has shown that the programme is not strict at all. This may be because it is inadequate and not feasible or because it is not desired by the Government or those implementing it. |
| Create a structure with clear responsibility and authority for implementing the programme | A clear structure has been established to be responsible for implementation of privatization. The major task of planning the privatization policy and the different programmes lies as a joint responsibility between the ministerial level and the executives of HCs and ACs. The specific programmes are proposed by the executives of the HCs and ACs together with the PEO (coordinator) and approved by the minister. This procedure means that genuine desirability of the programme among both levels is of ultimate |

| | |
|---|---|
| | importance. |
| Define responsibility of implementation clearly allowing for accountability | Although different responsibilities of the different implementing groups are clearly defined, yet accountability for delay in implementation and who should be held responsible is rather vague. |
| Develop a system of monitoring actual implementation with required accountability procedures | Although there is a ministerial committee in charge of monitoring implementation of the privatization programme, it seems to be of little effectiveness. Comparing actual implementation with initial objectives and plans shows slow implementation. Yet, no one has actually been blamed or punished for the delay of the planned programme till now. |
| Determine different methods of dealing with the management and work force | Several schemes have been developed and a new law is being studied. This will be dealt with in a separate chapter. |
| Develop a comprehensive marketing plan | Most promotional efforts are focused on advertising efforts for units offered for sale. Pricing is based on a case-by-case strategy. Local markets are reached efficiently but a lot remains to be done to reach more international markets. |
| Develop a mass-media-backing plan | Most efforts are directed to creating awareness of the programme in general and to the new role of the Stock Market in particular. Among the efforts are development of the existing Stock Market Magazine, devoting a whole page in the major daily newspapers for the Stock Market and its daily activity and the continuous monitoring of the official announcements concerning privatization. Coverage in other mass-media tools has been limited. |

## 4.12 Conclusion

This chapter aims to study whether privatization in Egypt is implemented by a clear structure with well-defined responsibilities to plan, organize and control the whole process and that is at the same time sufficiently backed by a Government truly committed to privatization. The chapter studies the structure governing privatization at both the policy and the implementation levels and then assesses actual Government commitment to privatization. It also reviews and evaluates privatization progress since its first announcement.

The analyses in this chapter lead to the following conclusions

- The privatization structure in Egypt is composed of four main agencies:

| | |
|---|---|
| A. The Public Business Sector Minister | (PE Minister) |
| B. The Public Enterprise Office | (PEO) |
| C. The holding companies | (HCs) |
| D. The affiliated companies | (ACs) |

- The privatization process is divided into three distinct phases: the preparation and valuation of SOEs, selecting privatization candidates and making the decision to sell them and the actual implementation phase.
- The GOE has established several selection criteria for choosing privatization candidates. The most important criteria are choosing profitable, medium-sized enterprises or business units, operating in competitive business sectors, which do not need financial restructuring, additional investment, operational reorganization, legal restructuring or significant corrective environmental measures.
- The GOE announces an annual programme of privatization candidates.
- According to the announced Government structure of privatization the major task of planning the privatization policy and the different programmes is a joint responsibility between the ministerial level and the executives of HCs and ACs. The specific programmes are proposed by the executives of the HCs and ACs together with the PEO and approved by the Minister. This procedure means that desirability of the programme among both levels is assumed. The Egyptian structure as such necessitates Government commitment and gives HC and AC executives a large role in choosing candidates for privatization and planning for implementation and later executing plans. This study raises the question as to whether the Government is truly committed to privatization and whether HC and AC executives of whose careers would be the most affected by the new policy, would genuinely desire privatization.

- The privatization structure does not include a clear and effective structure for communicating, monitoring and marketing privatization. Absence of such structure negatively affects feasibility of implementation.
- Although most specialists agree that privatization is the only way out of the deteriorating efficiency of the public enterprises, experience shows that actual implementation is very slow. Egypt is no exception. This could be attributed to several implementation problems, which leads us to the main focus of this dissertation on problems of implementation.
- The most active privatization year during the last decade was 1996 in which 25% of the privatization activity took place. This was followed closely by 1997 in which more than two thirds of the activity took place during the first six months. Only 21% of total privatization activity took place during the period 1991 to 1995 of which most activity took place in 1994 in the form of ESAs. The privatization pace slowed down again in 1998 (21% of the activity) and further still in 1999 (13% of the activity).
- Most of the privatization that took place (33%) was through public offerings. The second most frequent method used was sale to ESAs (26%). Liquidation accounted for 24% while sales to anchor investors did not exceed 17%.
- Actual implementation of privatization was way behind planned privatization. It was also far less than official announcements of intentions. At the same time, many of the Government objectives of the whole programme were hardly realized.
- In spite of the previously perceived practicality of offering IPOs , many analysts believe that IPOs can no longer be depended upon as the main method for selling privatized companies. The main reason behind this is that most of the remaining privatization candidates are not as profitable or as successful as the ones that have already been sold. Also, in contrast to the more difficult anchor sale method, IPOs do not help achieve the longer-term objectives of creating globally competitive industries. Alternative methods of privatization should be reconsidered. Anchor sales on the other hand need development of accurate valuation methods, international marketing, simplifying selling procedures and considering long term-objectives of efficiency to be more important than

proceeds maximization, to succeed. The most appropriate method of sale should be determined on a case-by-case basis.

- The delay could be explained by slackness at policy level planning, by problems at the industry level organization of the process or by actual implementation problems. In short, the plan was either inadequate, too optimistic or both.

# Chapter Five

# Managers' Views Regarding the Public Sector and Privatization

## 5.1 Introduction

As evident from the privatization structure and process in Egypt a large part of the responsibility of privatization implementation lies on the executives of holding and affiliated companies[1]. This is also evident from the three-level model mentioned in Chapter Three. The model shows that the programme is imposed from higher levels of policy making on SOEs and managers on their behalf participate by being entirely responsible for implementation. This makes attitudes of these managers of direct influence on the implementation process. This agrees with the views of many authors who emphasize the importance of managers' role in implementing change (Kanter, 1983) especially one as radical as privatization. However, acceptance of change by those managers is not always guaranteed. In many cases, changes in organizations create anxiety which might lead to insecurity and hence resistance of the new policies (Wilson, 1992 and Nadler 1993). The extent to which managers feel they are the "masters" of the changes (Thorne, 1991) affect their acceptance of changes. Desirability and acceptance of the privatization policy on the part of managers is indeed essential for smooth implementation and feasibility of the different programmes (Flushing and Kruegere, 1995, Clark and Soulsby, 1995, Dobni et al, 1996 and Johnson, 2000). It is therefore important to study attitudes and views of managers of SOEs and assess their degree of acceptability of the new policies and their implementation.

There appears to be very little previous empirical evidence on SOE managers' attitudes to and acceptability by them of privatization. This area needs exploration to assert whether executives and managers' attitudes and views are favourable to privatization or not and to what extent this has an effect on the implementation process as compared to other problems.

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[1] Discussed in detail in Chapter Four.

Managers' views have been solicited and assessed as both key informants who have knowledge of the Egyptian SOE sector and as the main implementers of privatization in SOEs. Having worked in SOEs for so many years the managers have a special perspective on the expected problems that might hinder privatization implementation. As the implementers of privatization, this study also seeks to solicit their views about privatization and whether they favour privatization. This chapter focuses on managers' understanding and orientation towards privatization and why or why not the public sector should be transferred to private hands. Their views about other aspects of privatization are examined in later chapters.

The chapter starts by describing the methodology and procedures used throughout the study. It then presents managers' views about the public sector and its objectives and whether it succeeded in attaining them. Managers' opinions about economic success factors and whether they exist in public enterprises are also examined. Finally, attitudes of top and middle level managers, in industrial and non-industrial companies, are examined to assess their understanding and orientation towards privatization.

## 5.2 Methodology of the Survey

The overall research strategy that includes the literature survey, case studies, interviews with some stakeholders and a survey of managers of SOEs was outlined in Chapter One and is briefly presented in this section. The survey of managers including methodology and technical aspects is described in more detail next.

A literature survey of relevant books and articles has been carried out to study privatization and problems of implementation. Relevant literature has been reviewed and embodied in each relevant chapter.

Based on the literature survey the study formulates a "Privatization Model" which should illustrate how good practice should be. The study then describes and analyzes the actual practice of privatization in Egypt in comparison with the Model. Implementation problems are identified and assessed at the macro-level, the industry level and the company level. The study limits its coverage to implementation up to the year 2000.

Case studies are used to depict what is actually happening in several areas of the research. Interviews are carried out where appropriate with relevant sources. Data of these case studies are either embodied in the main research report or included as annexes to relevant chapters.

Surveys of senior and middle managers of SOEs are a major part of this research. As noted above they are used to describe and study the opinions and attitudes of middle and higher level managers in industrial and non-industrial public enterprise companies regarding the different issues of privatization in Egypt. The surveys seek information from managers both as key informants on SOEs and as implementers of the new policy whose views should be analyzed to reveal how far they are committed to privatization. The following account summarizes the basic methods of research employed in the attitude survey.

### 5.2.1 The Attitude Survey

This part of the study is concerned with assessing the attitudes of Public Enterprise Company executives. Two questionnaires have been administered to solicit information from the following groups and appraise their attitudes to privatization:

- A sample of top management executives in holding and affiliated Public Enterprises (Questionnaire A).
- A sample of middle level managers in Affiliated Public Enterprises (Questionnaire B)

#### 5.2.1.1 *Population and Samples*

❖ **Population**

The Public Enterprise companies (PEs) in Egypt are categorized into two major groups: 17 holding companies and 315 affiliated companies. The researcher approached CEOs of holding and affiliated companies (using Questionnaire A) and middle managers of affiliated companies (using Questionnaire B). Both questionnaires are given as appendices[2]. Each CEO or manager has been taken to represent one company[3].

The total population consists of all top and all middle level managers who work in all PEs in Egypt. Sending questionnaires to all managers (thousands) and processing the returned data would have been prohibitively costly. Therefore, CEOs of all SOEs have been chosen to represent top management and Directors of Administration and Finance Departments (DAF) have been selected to represent middle management in their companies. The reason Directors of Administration and Finance Departments have been selected to represent middle management is their assumed awareness of the different administrative and personnel issues and problems in the different departments.

### ❖ Sampling Approaches

Different precautions are taken to ensure that the chosen sample represents the population in order to safely make generalizations. There are several types of sampling procedures that can, in theory, be used (Yamane, 1964). The most important are explained below.

- **Simple Random Sampling**

Two conditions have to exist for a sample to be 'random': every individual in the population should have an equal chance of being selected and the selection of one individual should be independent of and not in any way linked with, the selection of another. Tables of random numbers facilitate the selection process.

- **Systematic Sampling**

Systematic sampling involves using a list of all items in the population and then choosing every second (for example) or sixth or tenth item from the list, depending on the population and the size of the sample. Choosing the first individual or item randomly rather than picking the first one on the list is used in this type of sampling. It avoids bias especially if any kind of trend in the listing is suspected. Systematic sampling is generally considered to be equivalent to simple random sampling.

[2]Questionnaire A is included as appendix A and questionnaire B is included as Appendix B.

- **Stratified Sampling**

The main characteristic of this method is the division of the population into separate categories or "strata" and the independent selection of sub-samples from each stratum. In this case several main features of the population can be identified and categorized. To ensure that each of the categories is represented in the final sample the population is divided according to common features into strata and the stratified random sample within each stratum is selected at random. The main advantage of stratified sampling over simple random sampling is that it tends to give a more precise estimate of population values and ensures representation of all categories of the population (Deming, 1960). Some considerations affecting stratification should be taken into consideration:

- In stratifying the population it is preferable to choose a natural or pre-existing classification.
- It is simplest and safest to adopt the principle of proportionate stratified sampling to ensure that the proportion of individuals per stratum in the sample is the same as the proportion of the stratum in the population. This adds to precision in representativeness. This method of proportionate stratified sampling is justified on both intuitive and statistical grounds.
- It is possible to stratify on the basis of more than one variable. Yet, with this multiple stratification, it is rarely worthwhile to use more than three bases of stratification for both theoretical and practical reasons. The theoretical reason is that the bases of classification might not be independent, with the result that the degree of correlation between the basis of stratification and the variable under study will increase relatively slightly as new bases of classification are added. The practical reason is that, as the design becomes more complicated, it will be increasingly difficult to ensure the right proportion of the sample in each cell of the cross-classification.

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[3] In questions where there were several options managers were allowed to make more than one choice.

For the purpose of this study the research worker has judged that the multi-stage[4] stratified random sampling method is most suitable for the nature of the population under study in addition to ensuring more precise results. This is explained in the next section describing the sampling procedures used.

### ❖ Sampling Procedures Used in this Study

- **Company Type Selection**

Public Enterprise Companies are divided into two main types, namely holding and affiliated companies. When the simple random sampling procedure is applied to such a distribution, there is a chance that either none or too many of a specific type may be included in the sample. As a result, the sample may not adequately represent the population. Public Enterprise companies were divided into the two types and a certain number of companies were selected from each type. Statistical theory supports this judgment (Cochran, 1963).

There are a number of reasons for following this sampling procedure. The first and basic reason is that, given certain conditions, it may increase precision (Cochran, 1963). A second reason is that information concerning individual strata may be desired. A third reason is that it may make it more convenient to collect data for either physical or administrative reasons.

How the strata should be chosen depends mainly on the subjective judgment of the statistician. In this study existence of the two types of companies was the main reason for stratifying according to this variable. Table 5.1 describes the first stage of the sampling procedure used in this research.

**Table 5.1: First Stage Sampling: Company Selection**

| Company Type | Company Population | | Sample | |
|---|---|---|---|---|
| | No. | % | No. | % |
| Holding Company | 17 | 5.12 | 9 | 50 |
| Affiliated Company | 315 | 94.88 | 126 | 40 |
| Total | 332 | 100 | 135 | 43 |

*Source: Public Enterprise Office, 1991*

[4] Stratified sampling was used in more than one stage of sampling.

- **Management-level Selection**

One of the most important aspects that needed to be taken into consideration when deciding on how to stratify the population is the aim of the study. This is why the second stage sampling has divided the population according to management level. Two levels of management have been chosen to represent each company, namely, top management and middle management. The two categories were picked, due to their influence on the implementation process (See Clark and Soulsby, 1995 and Dopson and Stewart, 1993). CEOs have been chosen to represent top management and Directors of Administration and Finance Departments have been selected to represent middle management in their companies. A separate questionnaire was prepared for each group. This was mainly intended to reflect differences in the scope of responsibilities and the fact that CEOs would have a more strategic overview of organizational, administrative and personnel while middle managers would have a more detailed appreciation of organization issues. Questionnaire A has been directed to CEOs of holding and affiliated companies while questionnaire B has been directed to the managers of Administration and Finance Departments in holding and affiliated companies.

- **Top-level Management**

  The researcher approached CEOs of nine holding companies representing approximately 50% of the total population seeking interviews (there are 17 holding companies in Egypt). Six CEOs co-operated representing about 67% of those approached and 35% of the population. The researcher has also approached CEOs of 40% of the Affiliated companies. Seventy-nine CEOs co-operated (co-operation ratio of 63%) with the researcher, representing 25% of the total population of the Affiliated companies in Egypt.

- **Middle-level Management**

  Questionnaire B has been used with Directors of Administration and Finance departments (DAF) of Public Sector companies to represent middle level management. Self-administered questionnaires were distributed among DAFs of 9 holding companies representing 50% of the population. Four managers representing approximately 25% of DAFs of the holding companies responded. On the other hand 126 DAFs of affiliated companies representing 40% of the population were approached. One hundred and thirteen DAFs of affiliated companies representing approximately 36% of the population returned completed questionnaires. Table 5.2 describes the second stage of the sampling procedure used in this research.

**Table 5.2: Second Stage Sampling: Management Selection**

| | Type of Company | Population | Aimed Samples | | Companies that Cooperated | % of Aimed Sample | % of Population |
|---|---|---|---|---|---|---|---|
| | | | No. | % | | | |
| Top Management | HC | 17 | 9 | 50 | 6 | 67 | 35 |
| | AC | 315 | 126 | 40 | 79 | 63 | 25 |
| Middle Management | HC | 17 | 9 | 50 | 4 | 44 | 24 |
| | AC | 315 | 126 | 40 | 113 | 90 | 36 |

- **Manager and Company Characteristics**

Following the selection and implementation of the sample, managers have been classified according to whether the company they work in is an industrial company or a non-industrial company. The aim of this categorization is to identify any differences in the outlook on privatization- of managers because of the type of business in which they work.

### 5.2.1.2 Attitude Measurement

A large part of this study is concerned with the measurement and assessment of managers' attitudes to privatization. Attitudes can be defined as tendencies of individuals to act or react in certain ways if confronted by certain stimuli. It follows that while an individual's attitudes are present all the time, they are dormant most of the time. They only appear, whether in speech or behaviour, when the object of the attitude is perceived. Consequently, for research purposes, one has to find ways to uncover and measure the attitudes of respondents. There are many ways to attain this and the research methodology literature is rich in dealing with the subject. For the interested reader, one of the most popular references including a full account of direct and indirect methods of attitude measurement and questionnaire design is Oppenheim (1966). An account of the attitude measurement approach adopted in this study is given and justified below.

❖ **The Approach Employed in This Study**

There is no method that could be considered as the best in all research situations (Oppenheim, 1966). The researcher has to choose a method which is under study and the resources available. In assessing possible methods for use in this study, the indirect methods were judged to be inappropriate for several reasons. Firstly, their validity and reliability are doubtful. Secondly, they rely heavily on the interpretation of responses, which has its measurement problems. Thirdly, they would involve a great deal of work, time and resources beyond the ability of the researcher. Finally, the subject matter of this investigation is hardly suited for those indirect techniques (Thurstone, 1929).

The attitude-scaling method has, therefore, been used. The Lickert type scale (Lickert, 1932) has been preferred due to its possession of several merits. The most important of these are: ease of construction, ability to secure more precise information about agreement and disagreement, unidimensionality, reliability, suitability for the subject matter of the study and ease of administration. As to its weakness in reproducibility because identical total scores may have totally different meanings, this research study has concerned itself only with patterns of attitudes rather than total scores.

Attitude statements have thus been used, according to procedures recommended by Lickert, in a questionnaire to be filled in by respondents. This choice is supported by the tendency of most previous research workers to rely on this attitude scaling method in their works.

## 5.2.2 Construction of the Research Instrument - General Overview

❖ **A Restatement of the Main Issues**

A major part of this study examines managers' attitudes towards privatization and the different problems of implementation. This has been studied through two questionnaires used to examine the following main issues:

- Managers' understanding of the term 'privatization' and their attitudes towards its goals and possible drawbacks.
- Manager's views on major problems that might hinder implementation of privatization. This includes studying managers' views about the following issues:

- Are labor-related issues a major constraint on privatization?
- Are there problems in the present legal framework?
- Did the new law succeed in achieving its objectives?
  - Were problems of Law 97\1983 overcome?
  - Did new problems arise?
- Do higher and middle management levels resist privatization? If so is it due to:
  - Lack of clarity in the privatization policy?
  - Insufficient information?
  - Disagreement with privatization?
  - Insecurity?
  - Belief in efficiency of the public sector?
  - Questioning importance of quoted objectives of privatization?
  - Fear of privatization drawbacks?
- Are there problems in restructuring companies. If so, is this due to;
  - Inefficiency of the general Government policy on restructuring?
  - Existence of specific drawbacks in the government policy of restructuring individual companies?
- Are there problems in implementing different valuing methods?

### ❖ General Guidelines Adopted in Building and Administering the Research Instrument

*A pilot survey* was carried out at the beginning of this study. One of its aims was to guide the design of the research instrument. Thus, many of the choices made in this design were a direct result of the pilot work.

*Areas and items included in the questionnaire*: The main issues under study have been examined via the use of one or more items in the questionnaire as will be detailed in the following section.

*Open and closed questions*: The researcher needed to decide which to use in what items. Open or free-response questions invite the respondent to answer in the way he / she wishes. Their main advantage is the freedom they give to the respondent allowing him/her to answer freely in his/her own language, unencumbered by a prepared set of replies. They are easy to ask, difficult to answer and still more difficult to analyze. Probing is often required with the risk of introducing interviewer's bias. A closed question offers the respondent a choice of alternative replies. They can be used in both attitudinal and factual aspects. They are easier and quicker to answer. They require little writing and can be quantified easily. This means that more questions can be asked and more accomplished with a given quantity of resources. Disadvantages of closed questions are the loss of spontaneity and expressiveness and perhaps leading the respondent to choose from alternative replies that never occurred to him/her. But they are credited for reminding the respondent of items that would have otherwise been forgotten. Guided by previous relevant research, this researcher has found it necessary to use both types of questions using each type in the items judged to be beneficial to the study. When using closed questions, the alternative replies have relied on previous work to ensure that they are logical and all-inclusive of possible answers to the best knowledge of the researcher.

*Checklists and ranking items in a checklist*: These are elaborations of `closed' type of questions. Checklists require respondents to chose items from a list. Sometimes it is appropriate to ask respondents to rank items in a checklist in order of importance. Checklists and ratings have been used in a number of questionnaire items where they were judged to be appropriate.

### ❖ Construction of the Research Instrument: How the Research Issues Were Embodied

The main aims of the surveys are to solicit attitudes and to secure factual information about the areas of research. The areas of investigation are given below together with the more detailed questions under each. The precise questions that have been posed in the questionnaires are listed in Appendices A and B, but the number(s) of question(s) relating to a given area are given in brackets following the description of each area. The first 23 questions are the same in both questionnaires. The remaining questions are different with policy related questions placed in questionnaire A and operational questions in questionnaire B.

**A) Common Questions in both Questionnaires A and B**

- Managers' understanding of and orientation toward privatization:
    - Managers' understanding of 'privatization' (Q1)
    - Managers' agreement with privatization (Q2)
    - Managers' views about goals and possible achievements of privatization (Q3)

- Managers' views about drawbacks of privatization (Q4)
- Are managers really looking forward to privatization? (Q12 and 13)

- Managers' attitudes on problems hindering implementation of privatization and which problems are more important (Q11)
    - Workers' resistance
    - Unavailability of information
    - Political resistance
    - Media disagreement
    - Prospective buyers interest
- Managers' opinions about the public sector
    - Managers' views about the public sector and its objectives and whether it succeeded in attaining them (Q5, 6 and 7)
    - Managers' opinions about the disadvantages of the public sector (Q8)
    - What do managers think about different criticisms of the public sector, e.g. low efficiency, productivity and performance, and why? (Q9 and 10)
    - Is economic success possible in the public sector enterprises? ( Q14 and 15)
- Managers' opinions about the adequacy of the present legal framework organizing Public Enterprise Companies
    - What Law 203/1991 added or changed (Q16 and 17)
    - Will the new law lead to a change in the size of the public sector? (Q18)
    - Problems of the new law and proposed changes (Q 19 and 20)
    - Disadvantages of the previous law and whether the new law overcame them (Q21,22)

**B) Questions only in Questionnaire A (for senior managers)**

- Managers' views on Law 5/1991 (Q23).
- Managers' views on different financial aspects and the problems of valuation

- Managers' opinions about determining company value, who should perform the job and how accurate they think valuation could be (Q24, 25 and 26)
- Managers' views on the extent of financial success of their companies and whether the new law would help improve the situation (Q27, 28 and 29)
- Are the managers in favour of equality of financial treatment between public and business enterprises? (Q30, 31 and 32)
- What managers think about treatment of past debts (Q33)
- Would managers buy their company stock if it were offered for sale? (Q34)

- Managers' views about their company performance and whether the new system helped:
  - To what extent is the manager's company successful in attaining its objectives? (Q35 36 and 37)
  - Managers' opinions about effectiveness of the different systems applied in public sector companies, e.g. control systems, management structure, incentive systems, staffing methods and pricing (Q36 and 37)

**C) Questions only in Questionnaire (B)**

- Managers' views about problems in their companies.
  - Adequacy of staff size (Q23 and 24)
  - Reasons for low performance (Q33)
  - How effective is the incentive system? (Q34)
  - What the basis of promotion for staff should be (Q35)
- Managers' attitudes towards different options after privatization:
  - Would they buy shares and become owners? (Q25)
  - Would they quit if they were offered a good end-of-service bonus? (Q26)
  - Would they prefer retraining, transfer to another public company or start their own business? (Q27 and 28)
  - What do managers know about the Social Fund? (Q30)

- Do managers prefer to work in a private or public company?
  - What is the most important advantage their company offers them, while being owned by the Government? (Q29)
  - Do managers prefer working in a public or private company? (Q32)
  - Do managers think that privatization will benefit them, benefit the public company being privatized, benefit both the managers and the company or benefit neither? (Q31)

**❖ Construction of the Research Instrument: How it was Tested**

- **Validity**

A test is valid for any sphere of behaviour if it makes it possible to forecast the performance of the best with a degree of reliability. Validity is a relative concept; it is difficult to state that any particular figure indicates the validity of the instrument (Campbell, 1959).

One type of validity is known as convergent validity and the other, as discriminate validity. The distinction is concerned with the operations by which validity is determined. Moreover, it relates to determining what a test does not measure as well as to what it does. There is convergent validity when a test or other measure of a proposed trait correlates strongly with instruments of other kinds designed to measure the same trait, or that are thought to measure it. There is a call for evidence of the measurement of the construct by different methods, e.g. ratings (by self and by others) and performance tests as well as by published tests.

Discriminate validity is shown by the fact that the test correlates a little or not at all with measures of other traits, whether by the same method or by other methods. The search for high correlation among different methods of measuring the same trait and low correlation between measures of different traits would seem to be only a step in the direction of the more refined conception of factorial validity.

A test is valid in predicting outcomes if it correlates with an assessment of proficiency. Obtaining adequate criteria of what represents success is one of the most difficult aspects of predictive validity. Practical criteria needed to measure predictive validity are often very difficult to obtain and to measure adequately.

The basic philosophies of test makers differ considerably. On the one hand, there are those who prefer to develop tests that measure recognized basic variables. In other words, there is much concern with construct validity. This school of thought is generally divided between those who regard factor analysis, properly used, as the best means of demonstrating construct validity and those who do not. Supporters of factor analysis point out that it both isolates the trait involved and ascertains which tests measure it best. Their opponents depend upon inter-correlation of tests and other variables for evidence of construct validity.

The empirical school of thought is commonly represented among those who face practical problems of measurement. Of course, this does not mean that those who adopt primarily the empirical view are behaving irrationally or that they necessarily have no interest in basic concepts. There is quite a range of dispositions toward the rational school on the part of the empiricists. Both groups make much use of empirical steps of item analysis in test development. .

The empirical (judgment) approach has been applied to test validity since there is no concern regarding the personality traits involved in this study as possibly reflected by the total test score.

The questionnaires have been examined by a group of specialists with a thorough knowledge of the Egyptian public sector and privatization issues. They were asked to judge the questionnaire's validity, i.e. their ability to measure what they had been designed to measure, namely the managers' attitudes and opinions concerning the given issues about privatization. The jury consisted of five PE managers, five businessmen and four university professors. The aims of the questionnaires were explained to them. Every juror made his/her comments independently, then a meeting involving all the jurors was held in order to compare conclusions and advice on the final form of the questionnaires.

Ten managers read the questionnaires so as to judge the appropriateness of their language and the clarity of the questions (the original questionnaires are in Arabic). As a result some questions were rephrased.

The final versions were presented to five representatives of the jurors and they judged the final form (as presented in Appendices 1 and 2) to be appropriate for the study.

- **Reliability**

The reliability of a set of measurements is logically defined as the proportion of the variance that is true variance. There are many procedures to estimate the coefficient of reliability from empirical data (Guildford, 1987). These procedures fall into three general categories:

- Internal consistency reliability or simply internal consistencies;
- Alternate forms reliability, comparable forms reliability, or paralleled forms reliability; and
- Internal consistency and test-retest reliability

To determine internal consistency reliability it is necessary to compute the coefficient of consistency whereas to determine alternate form and test retest reliabilities for tests which give rise to total scores it is necessary to compute the coefficient of equivalence and stability respectively (Cronbach, 1951).

There is no one best way of estimating the coefficient of reliability. The method employed to estimate the coefficient of reliability depends upon the purposes and the meaning and the intended use of the results. A secondary consideration in using one of the three above measures to estimate the coefficient of reliability is the availability of data in the proper form as well as the testing conditions.

In general, the type of the test determines what kind of reliability should be used. Some tests tend to be homogeneous and others tend to be heterogeneous. A highly homogenous test measures the same ability (or abilities). On the other hand the heterogeneous test measures different variables in their various parts.

Homogeneity is a matter of internal-consistency. So, it should be indicated by an index of internal-consistency reliability. However, if the test is heterogeneous, so that different parts measure different traits, it is not expected to have a very high index of internal consistency. The only meaningful estimate of reliability for a heterogeneous test is provided by the test-re-test procedure.

The test-re-test method yields information about the stability of rank orders of individuals over a period of time. A high coefficient of reliability from this source indicates that persons change very little in status within their population from the first to the second testing. On the other hand a low coefficient of this type of reliability may mean that individuals have changed in different directions or in the same directions at different rates during the testing period.

In this research the retest method has been applied to test reliability. Ten CEOs and ten middle-level managers were chosen randomly from the different companies and were asked to complete the questionnaire again two weeks after completing it for the first time. Because the questionnaire does not give rise to a total score it was not possible to compute a coefficient of stability. Instead, the number and percentage of questions for which nobody, one person, two people etc. gave a different answer on the two occasions were determined. The results are presented in (Table 5.3) from which it may be seen that, for all of the questions, fewer than four people answered some of the questions differently. It may therefore be concluded that the questionnaire was sufficiently reliable.

**Table 5.3: The Number and Percentage of Questions for Which 0,1,2 or 3 Respondents Gave a Different Answer on the Two Occasions**

| | Number of Respondents Giving Different Answers | | | | |
|---|---|---|---|---|---|
| | 0 | 1 | 2 | 3 | 4+ |
| Number of Questions | 12 | 5 | 2 | 1 | 0 |
| Percentage of Questions | 60% | 25% | 10% | 5% | 0 |

## 5.2.3 Procedures Used

Two groups have been chosen to perform this survey: executives of HCs and ACs (top-level managers) and managers of Finance and Administration Departments (middle-level managers). The companies have been categorized into industrial and non-industrial companies with one manager representing each company at each of the top-level and middle-level management.

Managers' responses for all the questions have been summarized and tabulated. Percentages were then calculated for each question and each item and included in the relevant tables. The tables for most questions have been embodied in the text.

Weighted average has been used to calculate the average weights of items in five-scale questions with more than one statement used. The main aim has been to assess the degree of importance or the extent of agreement for each item in order to determine which items managers feel more strongly about.

The following procedure has been used to calculate the weights:

- Responses have been associated with weights starting with 5 for strongly agree / very important and so on till 1 for strongly disagree / least important.
- Frequencies of responses for each answer are then multiplied by the weights and afterwards divided by the total number of responses for each factor.
- The results of step 2 are then added for each factor.
- The outcome for these additions is a number between 1 and 5 indicating the extent of agreement / degree of importance of the factor. The higher the outcome the more agreed upon / important the factor is.
- The tables embodied in the different chapters show the frequency percentage of each individual response to each statement and the average weight of the item as a whole. The detailed tables for the 5-degree questions are included in appendix D.

## 5.3 Managers' Views Concerning the Public sector

Knowing that the executives and managers are the main implementers of privatization and that some of them are among the strongest defenders of the public sector system, the researcher found it important to assess their views concerning SOE performance and advantages / disadvantages of leaving them in the public sector.

### 5.3.1 Managers' Views Concerning the Most Important Objectives of the Public Sector (Q 5)

Managers' opinions concerning the most important objectives of SOEs before Law 203/1991 and whether they were actually attained have been investigated using two questions. The first is an open-ended question on managers' views regarding SOE objectives and the second is on their perception of whether they have actually been attained. This section describes responses to the first question in which senior and middle level managers were encouraged to mention all the SOE objectives they felt were important. The main purpose of the question was to investigate how managers perceive the objectives of public sector enterprises and how they rank them.

Among the different managers' responses were the following:

1- *Guarantee of continuous supply of different products at moderate prices (especially essential products).*

2- *Diversification of production and investment serving national development plans.*

3- *Creation of new jobs and curbing unemployment.*

4- *Supporting social justice causes.*

5- *Investment in areas the private sector cannot afford or is not interested in (e.g. infrastructure projects , security and heavy industries ...etc.).*

6- *Controlling production facilities and prevention of monopolies.*

7- *Production of competitive, high quality, low price products able to compete in internal or external markets.*

8- *Profit-making.*

9- *Right now the objective of the public sector is getting rid of loss making units.*

10- *No objective or I don't know.*

11- *Continuity.*

12- *Central planning of the national economy.*

13- *Restructuring the public sector.*

14- *Political reasons.*

15- *Replacing imported products.*

The most frequent answers are summarized in table 5.4 where the numbers in the first row refer to the numbers related to responses listed above.

**Table 5.4: Managers' Responses Concerning the Most Important Objectives of the Public Sector**

| Response → / Managers' Classification ↓ | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 8.2 | 16.5 | 4.1 | 8.2 | 7.7 | 7.2 | 4.1 | 9.8 | 2.1 |
| Manage-ment Level | S.M | 9.1 | 21.6 | 1.1 | 6.8 | 8.0 | 9.1 | 4.5 | 13.6 | 1.1 |
| | M.M | 7.5 | 12.3 | 6.6 | 9.4 | 7.5 | 5.7 | 3.8 | 6.6 | 2.8 |
| Com-pany Type | Indus. | 9.1 | 3.6 | 5.5 | 10.9 | 21.8 | 3.6 | 1.8 | 10.9 | 5.5 |
| | Non-Indus. | 9.0 | 22.1 | 4.1 | 8.2 | 1.6 | 9.8 | 4.1 | 10.7 | 0.8 |
| Senior Mgmt. | Indus | 7.1 | 0.0 | 0.0 | 7.1 | 28.6 | 7.1 | 0.0 | 21.4 | 7.1 |
| | Non Indus. | 12.3 | 28.1 | 1.8 | 8.8 | 3.5 | 12.3 | 3.5 | 15.8 | 0.0 |
| Middle Mgmt. | Indus | 9.8 | 4.9 | 7.3 | 12.2 | 19.5 | 2.4 | 2.4 | 7.3 | 4.9 |
| | Non Indust | 6.2 | 16.9 | 6.2 | 7.7 | 0.0 | 7.7 | 4.6 | 6.2 | 1.5 |

**Continued: Managers' Responses Concerning the Most Important Objectives of the Public Sector**

| Response → / Managers' Classification ↓ | | 10 | 11 | 12 | 13 | 0 | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 0.5 | 3.1 | 5.2 | 1.0 | 22.2 | 100.0 | 113.4 *** | |
| Manage-ment Level | S.M | 0.0 | 1.1 | 5.7 | 0.0 | 18.2 | 100.0 | 59.2 *** | 16.243 D.F=13 NS |
| | M.M | 0.9 | 4.7 | 4.7 | 1.9 | 25.5 | 100.0 | 70.7 *** | |
| Company Type | Inds | 0.0 | 1.8 | 10.9 | 1.8 | 12.7 | 100.0 | 27.09 ** | 44.242 *** D.F=13 |
| | Non Inds. | 0.8 | 4.1 | 1.6 | 0.8 | 22.1 | 100.0 | 109.09 *** | |
| Senior Mgmt. | Inds. | 0.0 | 0.0 | 14.3 | 0.0 | 7.1 | 100.0 | 15.39 NS | 22.419 * D.F=11 |
| | Non Inds. | 0.0 | 1.8 | 1.8 | 0.0 | 10.5 | 100.0 | 58.43 *** | |
| Middle Mgmt. | Inds | 0.0 | 2.4 | 9.8 | 2.4 | 14.6 | 100.0 | 15.558 NS | 27.422 ** D.F=13 |
| | Non Inds. | 1.5 | 6.2 | 1.5 | 1.5 | 32.3 | 100.0 | 74.807*** | |

(1) All figures are expressed as percentages of row total.

(2) *Significant at 0.05 level of significance

** Significant at 0.01 level of significance

*** Significant at 0.001 level of significance

NS Not significant

Managers' answers (all managers) could be rearranged according to their frequency in the following order:

*1- Diversification of production and investment serving national development plans.*

*2- Profit-making.*

*3- Guarantee of continuous supply of different products at moderate prices (especially essential products).*

*4- Supporting social justice causes (the same frequency as No. 3).*

*5 - Investment in areas the private sector cannot afford or is not interested in(e.g. infrastructure projects , security , heavy industries .......etc.).*

*6- Controlling production facilities and prevention of monopolies.*

*7- Central planning of the national economy.*

*8- Creation of new jobs and curbing unemployment.*

*9- Production of competitive, high quality, low price products able to compete in internal or external markets (the same frequency as No. 8)*

*10- Continuity*

*11- Right now the objective of the public sector is getting rid of loss making units.*

*13- Restructuring public sector.*

*14- Political reasons.*

*15- Replacing imported products.*

The answers show how the managers rank the different objectives of the public sector and which ones they feel are more important. The following comments can be made:

- The most frequent answer (16.5%) made by the managers, especially senior managers (21.6%), was *"Diversification of production and investment serving national development plans."* This response shows the previous importance of the centralized role of the government in national development planning and the identification of managers with this role.
- Surprisingly the second most frequent answer (9.8%) was *"profit-making"*. 13.6% of senior management made that statement, and 6.6% of middle management thought so too. This response shows how managers think that SOE's role had

changed from its initial social objectives to profit making. It raises questions as to whether the Government role in development should be planning, organizing and monitoring development plans or should be profit making which is supposedly the private sector's role. This response reflects the change in Government policy and the pressure on public sector to reduce reliance on Government support[5].

- Ranking an important Government objective such as *'job creation'* as eighth and *'political reasons'* as fourteenth as opposed to *'profit making'* which is second, makes one wonder whether managers of SOEs actually understood the previous Government objectives in establishing and managing SOEs. Most of the announced Government objectives were related to social objectives serving political aims, but practically managers perceive profit making as more important. Managers' responses reflect a communication problem which, the researcher thinks, still exists. On the other hand their choices might be a reflection of a change in their views concerning the priority of the different objectives. Perhaps managers now feel that social objectives of SOEs are not as important as profit making. Managers appear to be more accepting of commercial objectives and by implication of privatization.
- Although *'Replacing imported products'* had been one of the main announced objectives of SOEs for many years following the nationalization moves, it was ranked last by the managers. Giving the least weight (less than 1%) to such an important Government objective also reflects failure of SOEs to achieve this goal.
- In general the managers' responses have shown how they perceive the different SOE objectives. However, their ranking of these objectives has been quite different from what one would have expected. They have ranked *'diversification of production'* as most important, *'profit making'* second in importance, *'job creation'* eighth and *'replacing imports'* last. These responses, contradicting official Government announcements, show that either managers' perception of objectives of SOEs is at variance from the original goals, or that SOEs have not succeeded in achieving their aims. Managers' ranking of *'profit making'* as second indicates that managers do not oppose privatization on grounds of preserving the social role of the Government, which, according to the managers, is not such a

[5] Government policy changes have been presented in chapters two and three discussing the economic reform efforts and the privatization policy.

high priority. In fact, responses of the managers to this question could be considered favourable to privatization, since SOE managers already consider profit making as one of the main objectives of SOEs.

- The Chi-square tests show that the distribution of all the managers within the same group is different in most cases from that which could be expected on a chance basis. The differences related to level of management have been found to be statistically insignificant. Differences due to the type of company and whether it is industrial or non-industrial were found to be statistically significant. When senior managers were categorized into industrial and non-industrial companies there was a difference of low significance. When middle managers were categorized into industrial and non-industrial managers the difference was of mid significance.

## 5.3.2 To What Extent Were the Chosen Objectives Attained from the Managers' Points of View? (Q6)

Managers were then asked to mention to what extent was the chosen objective attained, from their points of view. They were given four options ranging between "to a large extent" and "not at all." Managers' responses are summarized in table 5.5.

**Table 5.5: To What Extent Were the Chosen Objective Attained from the Managers' Point of View?**

| Response → / Managers' Classification ↓ | | To a large extent | To some extent | Not at all | Non definite | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|
| All Managers | | 20.1 | 45.4 | 25.3 | 9.3 | 100.0 | 53.3 *** | |
| Managers | S.M | 17.0 | 52.3 | 23.9 | 6.8 | 100.0 | 40.1 *** | 3.62 D.F= 3 NS |
| | M.M | 22.6 | 39.6 | 26.4 | 11.3 | 100.0 | 17.3 *** | |
| Comp-Any | Inds | 12.7 | 41.8 | 38.2 | 7.3 | 100.0 | 22.65 *** | 6.963 D.F=3 NS |
| | Non In. | 22.1 | 46.7 | 20.5 | 10.7 | 100.0 | 34.46 *** | |
| Senior Mgmt. | Inds | 7.1 | 57.1 | 35.7 | 0.0 | 100.0 | 11.72 ** | 2.61 D.F=3 NS |
| | Non In. | 15.8 | 52.6 | 22.8 | 8.8 | 100.0 | 25.37 *** | |
| Middle Mgmt. | Inds | 14.6 | 36.6 | 39.0 | 9.8 | 100.0 | 10.95 * | 6.218 D.F=3 NS |
| | Non In. | 27.7 | 41.5 | 18.5 | 12.3 | 100.0 | 12.56 ** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The following observations can be made:

- Only 20.1% of the total number of managers stated that the public sector succeeded in achieving the objectives they had chosen earlier.
- While 25.3% of the total number of managers thought that these objectives were not attained at all, 45.4% of the managers agreed that the objectives had been attained *to some extent.*
- The Chi-square tests show that the distribution of all the managers within the same group is different, in all cases, from that which could be expected on a chance basis. The differences related to the level of management and the type of company have been found to be statistically insignificant, in all cases.
- Responses to this question show that so many managers admit that most of the SOEs have either not achieved their objectives to a very large extent or not at all. They also show a change in the SOE objectives, which have become oriented to more commercial objectives. This is favourable to privatization since managers themselves already admit the failure of SOEs in attaining their objectives.

## 5.3.3 Managers' Views Concerning Advantages of SOEs' Staying in Government Hands (Q7)

Since many of the managers are accused of being biased in favour of public ownership, this question has aimed to solicit the managers' real views concerning advantages of staying in public hands. The managers were given a number of statements on which the extent of their agreement has been solicited. Weighted average has been used to present a summary of the results and to assess the extent of agreement with the different statements (table 5.6). Detailed results are included in Appendix D, tables 1.A to 1.H.

**Table 5.6: Managers' Views Concerning Advantages of Public Sector's Staying in Government Hands**

| Response Frequency % and Weights → / Statement ↓ | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree | Total Weights |
|---|---|---|---|---|---|---|
| A. Public ownership results in higher efficiency | 30.4 | 48.5 | 10.8 | 7.2 | 3.1 | 3.95 |
| B. Public ownership guarantees tighter control | 16.0 | 43.3 | 12.9 | 23.2 | 4.6 | 3.43 |
| C. Public ownership serves development plans | 10.3 | 23.7 | 13.4 | 43.3 | 9.3 | 2.83 |
| D. Public ownership guarantees employment for graduates. | 13.9 | 30.4 | 11.9 | 29.9 | 13.9 | 3.02 |
| E. Public ownership guarantees low price products. | 16.0 | 29.9 | 10.8 | 33.5 | 9.8 | 3.09 |
| F. Political needs necessitate public ownership | 13.4 | 19.1 | 12.4 | 39.2 | 16.0 | 2.17 |
| G. Competition harms consumers while public monopolies don't | 42.8 | 42.3 | 7.2 | 5.1 | 2.6 | 4.18 |
| H. Private ownership could be greedy and not trustworthy | 5.7 | 15.5 | 13.9 | 51.0 | 13.9 | 2.48 |

The above results lead one to make the following observations:

- It is evident from the weighted average that managers strongly fear that competition might *'harm consumers'* while they assume *'public monopolies'* wouldn't. Actually they have given this factor the greatest importance for SOEs to stay in public hands. It is also evident from the same table that managers still fear that *"the private sector could be greedy and not trustworthy"* which they have given intermediate weight among these advantages. These responses reflect a continuing belief in the public sector and reveal a continuing fear of the private sector.
- It is also evident that many of the managers believe that public ownership guarantees high efficiency and tighter control. The relatively high weights managers give to these advantages also reflect managers' continued belief in public ownership, which would definitely affect their desire to transfer it to private hands.
- Low-priced products and guaranteed employment have also been indicated as important advantages of staying in public hands. This reflects management feeling of the importance of the social role of SOEs. However, guaranteed employment of new graduates has not been given as much weight as one would have expected.
- According to the weighted average the factor *'public ownership serves development plans'* was ranked sixth by the managers. Knowing that this was one of the major SOEs objective announced by the Government this response suggests that managers in charge of implementing Government plans and objectives either do not understand or do not agree with the announced objectives.
- Managers gave the factor *'political needs necessitate public ownership'* the least weights.
- If managers' answers are ranked according to weighted average they would appear as follows:

  1. *Competition harms consumers while public monopolies don't.*
  2. *Public ownership results in higher efficiency.*
  3. *Public ownership guarantees tighter control.*
  4. *Public ownership guarantees products with low prices.*

*5. Public ownership guarantees employment for graduates.*

*6. Public ownership serves development plans.*

*7. Private ownership could be greedy and not trustworthy.*

*8. Political needs necessitate public ownership.*

Furthermore the following results can be deduced from the detailed results in Appendix D:

- Unexpectedly, many managers (48.5%) agreed or strongly agreed (30.4%), that "public ownership guarantees high efficiency" was the main reason SOEs should stay in public hands. This response shows that many of the managers still want public ownership and believe it to be more efficient.
- "Public ownership guarantees tighter control" was another response many managers either agreed to (43.3%) or strongly agreed to (16.0%). This response is in keeping with the traditional reasons for public ownership.
- Many managers disagreed (43.3%) with the statement that "*Public ownership serves development plans*" was the main reason SOEs should be left in public hands. This is quite surprising since in another question many of the managers mentioned that as the main objective of the public sector.
- While 30.4% of the managers agreed that "*Public ownership guarantees employment for graduates*" was the main reason for keeping SOEs in public hands a sizable minority disagreed (29.9%).
- While 33.5% disagreed that "*Public ownership guarantees products with low prices*" was the main reason for keeping Government ownership, many managers agreed.
- "*Political needs necessitate public ownership*" was a statement many managers either disagreed (39.2%) or strongly disagreed with (16%).
- A majority of the managers either strongly agreed (42.8%) or agreed (42.3%) that "*Competition sometimes harms consumers while public monopolies don't*". This response shows the main concept behind continuing public ownership despite its proven inefficiency.
- "Private ownership could be greedy and not trustworthy" was a statement that a dominant majority (64.9%) either disagreed with or strongly disagreed with. Only 21.2% agreed or strongly agreed with this statement. This result suggests

a rather more positive response to private ownership than responses to some of the other statements under Question 7.

- The Chi-square tests show that the distribution of all the managers within the same group is different in all cases from that which could be expected on a chance basis. Differences due to the type of company and management level have been found to be insignificant in most cases except in statement D and statement E where differences due to management level were significant.
- These results show that many of the managers still believe that there are many advantages of SOEs staying in Government hands. Their answers also show that many of them still do not believe in competition and do not trust the private sector. These views are understandable since managers are familiar with the existing system and the beliefs it is based on. They have also, in most cases, benefited from it. Change usually increases uncertainty. Privatization could be threatening. This would definitely have a negative impact on the extent of desirability of the privatization policy and of transferring SOEs to private hands.

### 5.3.4 Managers' Views on Major Disadvantages of Public Sector Companies Being Owned by the Government (Q8)

After asking managers about the major advantages of SOEs being owned by the Government, managers were asked to express their opinions regarding major disadvantages of the companies being owned by the government. Managers were given eight different statements from which they could choose. The managers were encouraged to choose any number of statements they wished.

The following statements were presented to them:

*1- No advantages.*

*2- Bureaucracy.*

*3- Mushrooming of the organization.*

*4- Slow decision making.*

*5- Government interference in company's affairs.*

*6- Disguised unemployment.*

*7- Low productivity.*

8- *Others (Please specify).*

Managers' answers are summarized and tabulated in table 5.7 where numbers in the top row refer to the above statements.

**Table 5.7: Major Disadvantages of Public Sector Companies Being Owned by the Government from the Managers' Points of View**

| Response → / Managers' Classification ↓ | | 1. | 2 | 3 | 4 | 5 | 6 | 7 | 8 | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 2.6 | 68.0 | 9.3 | 8.2 | 7.2 | 1.5 | 0.5 | 2.6 | 100 | 557.7 *** | |
| Mgmt. Level | S.M | 2.3 | 77.3 | 9.1 | 5.7 | 3.4 | 1.1 | 0.0 | 1.1 | 100 | 341.9 *** | 8.905 D.F=7 NS |
| | M.M | 2.8 | 60.4 | 9.4 | 10.4 | 10.4 | 1.9 | 0.9 | 3.8 | 100 | 230.4*** | |
| Comp-any Type | Inds | 0.0 | 72.7 | 9.1 | 5.5 | 7.3 | 0.0 | 1.8 | 3.6 | 100 | 175.72 *** | 7.586 D.F=7 NS |
| | Non In. | 4.1 | 63.9 | 9.0 | 10.7 | 7.4 | 2.5 | 0.0 | 2.5 | 100 | 295.02 *** | |
| Senior Mgmt. | Inds | 0.0 | 85.7 | 14.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 100 | 60.0 *** | 3.62 D.F=6 NS |
| | Non In. | 3.5 | 73.7 | 7.0 | 8.8 | 3.5 | 1.8 | 0.0 | 1.8 | 100 | 166.77 *** | |
| Middle Mgmt. | Inds | 0.0 | 68.3 | 7.3 | 7.3 | 9.8 | 0.0 | 2.4 | 4.9 | 100 | 134.62 *** | 6.595 D.F=7 NS |
| | Non In | 4.6 | 55.4 | 10.8 | 12.3 | 10.8 | 3.1 | 0.0 | 3.1 | 100 | 115.48 *** | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The following results are evident:

- A large majority (68%) of the total number of managers stated that *"Bureaucracy"* is the major disadvantage of the public sector being owned by the Government. It was viewed as the major disadvantage by senior managers (77.3%) and middle level managers (60.4%), in industrial (72.7%) or non-industrial (63.9%) companies. This could be interpreted to imply that managers think that efficiency of the public sector could improve if it moves out of Government hands with all the *bureaucracy* involved, or, given their suspicion of privatization, they would prefer greater autonomy of SOEs[6].

[6] Most recent SOE reform efforts endeavor to give managers more autonomy in decision-making (see Chapter Two).

- Among the other answers that were also frequent to a certain extent were *"slow decision making"* and *"Government interference in company's affairs."*
- *"Disguised unemployment"* and *"low productivity"*, evident as they are in the Egyptian context, were rare answers.
- The Chi-square tests show that the distribution of all the managers within the same group is different in all cases from that which could be expected on a chance basis. Differences due to the type of company have been found insignificant in all cases.
- The managers' responses show that many of the managers see some disadvantages in Government ownership of the SOEs. This reflects their preference for greater autonomy and could be considered an important step towards their acceptance of privatization.

### 5.3.5 Managers' Extent of Agreement with Inefficiency and Low Productivity Accusations Directed against SOEs (Q. 9)

Managers' views on inefficiency and low productivity in SOEs were sought through a question requiring a response on a five-degree scale. Answers are summarized in table 5.8.

**Table 5.8: Managers' Extent of Agreement with Inefficiency and Low Productivity Accusations Directed against SOEs**

| Response → / Managers' Classification ↓ | | Strongly Agree | Agree | Un-decided | Dis-agree | Strongly Disagree | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 1.5 | 7.7 | 4.6 | 57.7 | 28.4 | 100.0 | 212.4 *** | |
| Management Level | S.M | 1.1 | 8.0 | 6.8 | 62.5 | 21.6 | 100.0 | 109.3 *** | 5.064 D.F=4 NS |
| | M.M | 1.9 | 7.5 | 2.8 | 53.8 | 34.0 | 100.0 | 107.0 *** | |
| Company Type | Inds | 1.8 | 7.3 | 5.5 | 58.2 | 27.3 | 100.0 | 56.48 *** | 0.18 D.F=4 NS |
| | Non In. | 1.6 | 9.0 | 4.9 | 58.2 | 26.2 | 100.0 | 128.77 *** | |
| Senior Mgmt. | Inds | 0.0 | 14.3 | 14.3 | 64.3 | 7.1 | 100.0 | 18.14 ** | 2.08 NS D.F=4 |
| | Non In. | 1.8 | 8.8 | 7.0 | 64.9 | 17.5 | 100.0 | 75.54 *** | |
| Middle Mgmt. | Inds | 2.4 | 4.9 | 2.4 | 56.1 | 34.1 | 100.0 | 48.15 *** | 0.843 NS D.F=4 |
| | Non In | 1.5 | 9.2 | 3.1 | 52.3 | 33.8 | 100.0 | 64.31 *** | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

- Most SOE managers either disagreed (57.7%) or strongly disagreed (28.4%) with the statement that SOEs were inefficient and characterized by low productivity. Earlier tables in Chapter Two have shown how private and public sectors compare in terms of productivity and efficiency. Managers' disagreement could be explained by their lack of awareness of more efficient ways of doing things or their misinterpretation of the term productivity as production, or simply defensive response. However, their disagreement with this statement is not very surprising, since it appears to hold them responsible for the inadequacies of the public sector. Yet, no reform could succeed without those managers and others, who are actually responsible for SOE performance, starting to admit their shortcomings, especially if they are to continue in their positions and be in charge of implementing reform measures.
- The Chi-square tests show that the distribution of all the managers within the same group is different in all cases from that which could be expected on a chance basis. Differences due to the type of company and management level are insignificant in all cases.

### 5.3.6 Managers' Views about the Relative Importance of the Possible Factors Causing Low Performance of SOEs (Q10)

The managers' attitudes on the relative importance of the possible factors causing low performance have also been questioned. Managers were given 10 possible reasons and were asked to indicate the relative importance of each. The responses are summarized and tabulated in tables 2. A to 2. J in Appendix D. Table 5.9 presents a brief account of the results including weighted average of the answers using a five-degree scale giving 'very important' the value 5 and 'least important' the value 1.

**Table 5.9: Managers' Views about the Relative Importance of the Possible Factors Causing Low Performance of SOEs**

| Frequency % of Responses and Average Weights of Statements → | Very Important | Important | Neutral | Un-important | Not at all important | Weighted Average |
|---|---|---|---|---|---|---|
| A. Slow decision-making | 55.2 | 33.5 | 8.8 | 1.5 | 1.0 | 4.40 |
| B. Bureaucracy | 41.8 | 41.8 | 11.3 | 1.5 | 3.6 | 4.17 |
| C. Too many factors to consider | 25.8 | 48.4 | 14.9 | 8.8 | 2.1 | 3.88 |
| D. Commitment to graduates employment | 23.7 | 33.0 | 24.2 | 10.8 | 8.2 | 3.54 |
| E. Political influence on company | 49.0 | 38.7 | 8.2 | 2.1 | 2.1 | 4.31 |
| F. Difficulty of control in public sector | 20.6 | 23.7 | 32.0 | 15.5 | 8.2 | 3.33 |
| G. Low management skills | 36.6 | 45.4 | 10.3 | 5.7 | 2.1 | 4.08 |
| H. Inefficient training programs | 28.9 | 45.9 | 16.0 | 6.7 | 2.6 | 3.92 |
| I. Weak financial resources | 39.2 | 37.6 | 12.8 | 7.2 | 3.1 | 4.03 |
| J. Absence of private owner's control and concern | 47.9 | 26.3 | 18.0 | 4.1 | 3.6 | 4.11 |

The following results can be deduced from tables 5.9:

- The weighted averages show that managers have given the greatest importance to *'slow decision making'* as a factor hindering public sector performance. One could safely say that this is also one of the major problems facing implementation of privatization.

* Next, with nearly equal importance was *'political influence on SOEs'*. Although many of the public sector development plans have attempted to give decision makers in SOEs more autonomy, the political factor has been the major influence behind many of the decisions and policies of SOEs, e.g. recruitment decisions and pricing policies. Actually, many of the managers interviewed claim that most of the losses SOEs incurred were a result of political interference.
* *'Bureaucracy'* was the next hindering factor the managers identified as causing the low performance of SOEs. Many of them also felt that *'bureaucracy'* is a major disadvantage of the public sector (section 4.5).
* *'Absence of private owners' control and concern'* was also given a relatively high weight by the managers. This response is favourable to the privatization policy, since it shows that many of the managers admit that private owners' control and concern with commercial objectives improve company performance.
* *'Low management skills'* and *'inefficient training programs'* were given nearly equal weights. As evident both factors are related and could form a vicious circle causing low performance.
* *'Weak financial resources'* was also mentioned as one of the factors causing low performance. This ignores the many subsidies SOEs receive. It certainly reflects bad management.
* The managers did not rank *'commitment to graduate employment'* as one of the major problems hindering performance. In an interview, one of the managers interpreted this by saying that efficient management could always make use of extra manpower.
* *'Difficulty of control in the public sector'* was given the least weight by the managers. This is natural since most of the bureaucratic procedures are initiated mainly to increase control.

If statements were to be ranked according to their weighted average scores, to show how managers rank the different factors that cause low performance of SOEs, they would appear as follows:

1. *Slow decision-making.*
2. *Political influence on company*

3. *Bureaucracy.*
4. *Absence of private owners' control and concern*
5. *Low management skills*
6. *Weak financial resources*
7. *Inefficient training programs*
8. *Too many factors to consider*
9. *Commitment to graduate employment*
10. *Difficulty of control in public sector*

Furthermore the following results can be deduced from the detailed results in Appendix D:

- "*Slow decision making*" was indicated by most of the managers as one of the most important factors causing low performance of the public sector. Managers of the SOEs who thought that this factor was either most important (55.2%) or important (33.5%) represented 88.7% of the total number of managers.
- "Bureaucracy" was another factor most managers (83.6%) indicated as either most important (41.8%) or important (41.8%).
- A majority of managers (74.2%) thought that the numerous factors (e.g. commercial, social and political considerations) that had to considered was either an important factor (48.4%) or a very important factor (25.8%).
- The Chi-square tests for the previous three statements, A, B and C, have shown that the distribution of all the managers within the same group is different in all cases from that which could be expected on a chance basis. Differences due to the type of company and whether it is industrial or non-industrial have been found to be insignificant in all cases.
- "*Commitment to graduate employment*" was also viewed by many (56.7%) of the managers as either very important (23.7%) or important (33%). The Chi-square test showed that the distribution of all the managers within the same group is different in most cases from that which could be expected on a chance basis. Differences due to the type of company and whether it is industrial or non-industrial were found to be insignificant in all cases.

- *"Political influence"* was also viewed as one of the important factors, by many (87.7%) of the managers. 49% of the total number of managers thought it was very important while 38.7% thought it was important. The Chi-square tests for the statement showed that the distribution of all the managers within the same group was different in all cases from that which could be expected on a chance basis. Differences due to the type of company and whether it is industrial or non-industrial were found to be insignificant in all cases.
- 32% of the managers neutral on the *"Difficulty of control in the public sector"*. 44.3% of the total number of managers found it either important (23.7%) or most important ( 20.6%). The Chi-square tests for the statement showed that the distribution of all the managers within the same group was different in most cases from that which could be expected on a chance basis. Differences due to the type of company and whether it is industrial or non-industrial were found to be insignificant in all cases.
- 82% of the managers admitted that *"low management skills"* was either the most important (36.6%) or an important (45.4%) factor causing low performance of SOEs.
- *"Inefficient training programmes"* were also indicated as either a most important (28.9%) or an important (45.9%) factor affecting performance of SOEs by most of the managers (74.8%).
- Most managers (76.8%) thought that *"weak financial resources"* was either the most important (39.2%) or an important ( 37.6%) factor causing low performance.
- The Chi-square tests for the previous three statements G, H and I have shown that the distribution of all the managers within the same group is different in all cases from that which could be expected on a chance basis. Differences due to the type of company and whether it is industrial or non-industrial have been found to be insignificant in all cases.
- 74.2% of the managers admitted that *"absence of private owners' control and concern"* was either the most important (47.9%) or an important (26.3%) factor causing low performance of the SOEs. The Chi-square tests for the statement showed that the distribution of all the managers within the same group was different in most cases from that which could be expected on a

chance basis. Differences due to the type of company and whether it is industrial or non-industrial were found to be insignificant in all cases.

This question reveals how managers rank the different factors causing low performance of SOEs. Their ranking could be used in marketing the privatization policy, especially that most of the specified disadvantages are common features of public ownership. Managers may be shown how these disadvantages can be overcome by implementation of privatization. Managers' choice of *"absence of private owners' control and concern"* as one of the main factors causing low performance suggests that the managers accept the role of privatization in improving the performance of SOEs.

## 5.3.7 Managers' Opinions Concerning the Most Important Success Factor in Economic Enterprises (Q14)

In two successive questions managers were also asked to identify, in their opinion, what the most important success factor in business enterprises was and whether it was more evident in privately or publicly owned companies. The first question aimed to solicit their views about the success factors. Managers were given four alternatives to choose from and were asked to mention any other factors they thought were important. The factors that were presented to them were:

*1- Efficient marketing.*

*2- Acceptable financial structure.*

*3- High product quality.*

*4- Low costs.*

The answers are summarized and tabulated in table 5.10.

**Table 5.10: Managers' Opinions Concerning the Most Important Success Factor in Economic Enterprises**

| Response → / Managers' Classification ↓ | | 1 | 2 | 3 | 4 | 0 | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 82.0 | 10.8 | 5.2 | 0.5 | 1.5 | 100.0 | 471.8 *** | |
| Management | S.M | 84.1 | 8.0 | 5.7 | 0.0 | 2.3 | 100.0 | 227.5 *** | 2.78 |
| | M.M | 80.2 | 13.2 | 4.7 | 0.9 | 0.9 | 100.0 | 245.3 *** | NS D.F=4 |
| Company | Inds | . 80.0 | 12.7 | 5.5 | 0.0 | 1.8 | 100.0 | 120.48 *** | 1.296 |
| | Non In. | 84.4 | 9.8 | 3.3 | 0.8 | 1.6 | 100.0 | 313.17 *** | NS D.F=4 |
| Senior Mgmt. | Inds | 92.9 | 0.0 | 0.0 | 0.0 | 7.1 | 100.0 | 34.57 *** | 2.94 |
| | Non In. | 86.0 | 8.8 | 3.5 | 0.0 | 1.8 | 100.0 | 111.2 *** | NS D.F=4 |
| Middle Mgmt. | Inds | 75.6 | 17.1 | 7.3 | 0.0 | 0.0 | 100.0 | 79.98 *** | 3.15 |
| | Non In | 83.1 | 10.8 | 3.1 | 1.5 | 1.5 | 100.0 | 163.54 *** | NS D.F=4 |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The following remarks could be noted:

- There was overwhelming agreement (82%) that "*efficient marketing*" was the most important success factor of business enterprises. This attitude was evident among senior managers (84.1%) and middle level managers (80.2%), in industrial (80%) and non-industrial (80%) SOEs alike. The reason behind this could be that one of the biggest problems facing many SOEs is slow-moving stocks of finished goods (See 7.7.2.2). Although managers are aware that this is mainly a marketing problem, inventory levels in SOEs show that little has been done to overcome it. In one of the case studies (Annex to Chapter Seven) managers claimed that this was a factor beyond their control since their company had been production oriented for many years. The company's level of success was measured by quantity produced rather than by quantity sold.
- Acceptable financial structure was mentioned by 10.8% of the managers as an important success factor. This response, low as it is, is the second most important and could be because of concerns about the high debt/equity ratios of SOEs. The low response in comparison with *"efficient marketing"* is possibly

because most of the managers assume that improved marketing would lead to an improved financial position. The low importance given to the other two factors is possibly because of lack of recognition that "*high product quality*" and "*low costs*" are necessary complements to "*efficient marketing*" for improvement of performance.

- The Chi-square tests show that the distribution of all the managers within the same group is different in all cases from that which could be expected on a chance basis. Differences due to the type of company and management level are insignificant in all cases.

### 5.3.8 Managers' Opinions Concerning whether the Success Factor They Chose was More Evident in the Private or Public Sector (Q15)

Next, managers were asked to state their views on whether the success factor they chose was more evident in the private or public sector companies. They were given the four following alternatives from which to choose:

*1- Private sector companies.*

*2- Public sector companies.*

*3- Private sector and public sector alike.*

*4- Hardly evident in either.*

Table 5.11 summarizes their answers. It should be noted that numbers in the top row refer to each alternative's number.

**Table 5.11: Managers' Opinions Concerning whether the Success Factor They Chose was More Evident in the Private or the Public Sector**

| Response → / Managers' Classification ↓ | | 1 | 2 | 3 | 4 | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|
| All Managers | | 66.0 | 4.6 | 26.3 | 3.1 | 100.0 | 199.8 *** | |
| Management Level | S.M | 59.1 | 4.5 | 31.8 | 4.5 | 100.0 | 71.9 *** | 4.13 D.F=3 NS |
| | M.M | 71.7 | 4.7 | 21.7 | 1.9 | 100.0 | 133.9 *** | |
| Type of Business | Inds | 76.4 | 0.0 | 21.8 | 1.8 | 100.0 | 63.99 *** | 5.397 D.F=3 NS |
| | Non In. | 62.3 | 5.7 | 27.9 | 4.1 | 100.0 | 105.35 *** | |
| Senior Mgmt. Only | Inds | 78.6 | 0.0 | 14.3 | 7.1 | 100.0 | 22.0 *** | 3.44 D.F=3 NS |
| | Non In. | 54.4 | 3.5 | 36.8 | 5.3 | 100.0 | 42.15 *** | |
| Middle Mgmt. Only | Inds | 75.6 | 0.0 | 24.4 | 0.0 | 100.0 | 62.21 *** | 4.78 D.F=3 NS |
| | Non In | 69.2 | 7.7 | 20.0 | 3.1 | 100.0 | 71.58 *** | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The following observations can be made:

- As shown in the table, 66% of the managers felt that the success factor they chose was more evident in the private sector. This was so for senior managers (59.1%) and middle managers (71.1%) in both industrial (76.4%) and non-industrial companies (62.3%). This response is favourable to privatization since managers who believe that success factors are more evident in the private sector would be easier to convince of the advantages of privatization. However, they may also feel threatened by being exposed to competition in the private sector.
- Approximately 26% of the managers thought it was evident in both the public and private sector companies alike.
- The Chi-square tests have shown that the distribution of all the managers within the same group is different in all cases from that which could be expected on a chance basis. Differences due to the type of company and management level are insignificant in all cases.

## 5.4 Managers' Attitudes to Privatization

As evident from the privatization structure and process in Egypt the holding and affiliated companies are among the parties responsible for implementation of privatization. HCs initiate, administer and implement the privatization of affiliated companies or their assets as part of their annual business plan under the supervision of the PE Minister. ACs implement the plan in the normal course of their business and in some cases the managers can initiate divestiture of their companies (see section 4.3). In this section attitudes of top and middle level managers, in industrial and non-industrial companies, are examined to assess their understanding and orientation towards privatization.

### 5.4.1 Managers' Understanding of the Term "Privatization" (Q1)

In order to study managers' understanding of the term "privatization", managers were asked directly what the term meant to them. They were given five different alternatives and were allowed to choose more than one answer if they so wished. Managers were also encouraged to express their own understanding of the word.

The alternatives offered to the managers were:

*A- Sale of public sector enterprises (or assets).*

*B- A drive towards a more liberalized economy.*

*C- Getting rid of some loss making companies.*

*D- A change in management and management systems of the public sector companies.*

*E- A change in the law governing the public sector.*

*F- Other (please specify).*

The managers' answers are summarized and tabulated in table 5.12. The top row in the table refers to the different options.

**Table 5.12: Managers' Understanding of the Term "privatization"**

| Response → / Managers' Classification ↓ | | A | B | C | D | E | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|
| All managers | | 31.4 | 70.6 | 32.5 | 35.1 | 19.6 | 76.15*** | |
| Level of Management | Senior Mgmt. | 22.7 | 77.3 | 30.7 | 43.2 | 27.3 | 42.57*** | 11.658* D.F=4 |
| | Middle Mgmt. | 38.7 | 65.1 | 34.0 | 28.3 | 13.2 | 42.47*** | |
| Type of Business | Industrial | 30.9 | 74.5 | 30.9 | 27.3 | 12.7 | 33.567*** | 1.682 D.F=4 NS |
| | Non-In. | 31.1 | 74.6 | 32.8 | 35.2 | 21.3 | 52.966*** | |
| Senior Managers | Industrial | 7.1 | 85.7 | 42.9 | 42.9 | 21.4 | 12.358* | 1.27 D.F=4 NS |
| | Non-In. | 22.8 | 89.5 | 26.3 | 38.6 | 28.1 | 42.615*** | |
| Middle Managers | Industrial | 39.6 | 70.7 | 26.8 | 22.0 | 9.8 | 26.289*** | 1.463 D.F=4 |
| | Non-In. | 38.5 | 42.0 | 38.5 | 32.3 | 15.4 | 19.123*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

- A high percentage (70.6%) of the answers mentioned "*a drive towards a more liberalized economy*" as one of their choices. This reflects managers' understanding of what is actually behind the term.
- On the other hand a small proportion of the answers (31.4%) viewed privatization as sale of public sector enterprises. They conceive of privatization as reform in restructuring, changing procedures, giving more authority to company executives but not necessarily sale of SOEs.
- There was also a considerable number of managers (35.1%) who mentioned changing management and management systems among their choices. This reflects their concern about possible changes in management systems and managers.
- The next most frequent choice was "*getting rid of some loss making companies*", which many of the managers also felt was important.

- 19.6% of the managers thought that privatization is merely a change in the legal framework governing the public sector.
- The Chi-square test has shown that in all cases the distribution of the managers within each group is different from that which could be expected on a chance basis. The statistical difference has been recorded at the level of 0.001, which is a highly significant difference in most cases. The Chi-square test has also shown that the differences related to level of management and whether the company is industrial or non-industrial have proved to be statistically insignificant in most cases. The difference has been statistically significant (at the level of 0.05), only when attitudes of senior and middle managers as a total were compared.
- The managers' responses to this question show that although most managers agree that privatization is *"a drive towards a more liberalized economy"* many of them do not accept *selling* SOEs. This shows that many managers either do not understand or do not accept sale as an inevitable consequence of privatization. They understand privatization as a group of reform measures and procedures heading towards a more liberalized economy. They conceive of privatization as reform in restructuring, changing procedures, and giving more authority to company executives but not necessarily as selling SOEs. This attitude reflects reluctance to face up to full privatization and could in part explain the relatively slow progress of privatization. Managers appear to prefer greater autonomy given to them rather than privatization.

## 5.4.2 Extent of Managers' Agreement with the Privatization Policy (Q2)

Extent of managers' agreement with the privatization policy has been measured by using a five-degree scale question. The answers have been summarized and tabulated in table 5.13.

**Table 5.13: Extent of Managers' Agreement with the Privatization Policy**

| Response → / Managers' Classification ↓ | | Strongly Agree | Agree | Neutral | Dis-agree | Strongly Disagree | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|
| All managers | | 37.6 | 53.1 | 7.2 | 2.1 | 0.0 | 100.0 | 232.9*** | |
| Level of Manage-ment | Senior Mgmt. | 37.5 | 55.7 | 5.7 | 1.1 | 0.0 | 100.0 | 111.67*** | 1.399 D.F=3 |
| | Middle Mgmt. | 37.7 | 50.9 | 8.5 | 2.8 | 0.0 | 100.0 | 111.26*** | NS |
| Type of Business | Indus-trial | 41.8 | 49.1 | 5.5 | 3.6 | - | 100.0 | 55.57*** | 2.81 D.F=3 |
| | Non-In. | 35.2 | 56.6 | 7.4 | 0.8 | - | 100.0 | 147.13*** | NS |
| Senior Managers | Indus-trial | 50.0 | 50.0 | 0.0 | 0.0 | 0.0 | 100.0 | 21.0*** | 1.836 D.F=2 |
| | Non-In. | 33.3 | 61.4 | 5.3 | 0.0 | 0.0 | 100.0 | 82.91*** | NS |
| Middle Managers | Indus-trial | 39.0 | 48.8 | 7.3 | 4.9 | 0.0 | 100.0 | 40.59*** | 1.19 D.F.=3 |
| | Non-In | 36.9 | 52.3 | 1.2 | 1.5 | 0.0 | 100.0 | 66.39*** | NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The following remarks can be noticed in the table:

- A large majority of managers stated they agree (53.1%) or strongly agree (37.6%) with the policy of privatization, but as evident from the last question this does not necessarily mean they agree to the sale of PEs.
- Whether the respondents were senior managers or middle level managers in industrial or non-industrial companies the majority agreed, which reflects the acceptance of the policy of privatization among the different categories of managers.
- None of the respondents strongly disagreed with the privatization policy and a negligible percentage disagreed.
- The Chi-square tests show that the distribution of managers within each group is different, in all cases, from that which one would expect on a chance basis. The statistical difference has been recorded at the level of 0.001, which is a highly significant difference in all cases. The Chi-square tests also show that the differences related to level of management and whether the company is

industrial or non-industrial have proved to be statistically insignificant in all cases.

### 5.4.3 Managers' Views Concerning Goals and Possible Achievements of Privatization (Q3)

To rank the importance of the different goals and possible achievements of privatization from the managers' points of view, managers were asked to indicate the importance of each of seven possible goals presented to them. The respondents were also asked to indicate any other possible achievements they thought were important.

Table 5.14 summarizes the managers' responses on the degree of importance of each of the different goals and possible achievements of privatization. Weighted average has been calculated for each statement and included in the table.

**Table 5.14: Managers' Views Concerning Goals and Possible Achievements of Privatization**

| Frequency % of Responses and Average Weights of Statements → | Very Important | Important | Neutral | Un-important | Not at all important | Weighted Average |
|---|---|---|---|---|---|---|
| A. Increase in efficiency in public sector companies. | 56.2 | 27.3 | 10.3 | 4.1 | 2.1 | 4.81 |
| B. Widening the base of ownership through selling shares to the largest number | 41.7 | 34.5 | 16.0 | 5.7 | 2.1 | 4.08 |
| C. Earning revenue for the government | 18.0 | 24.2 | 26.8 | 17.0 | 13.9 | 3.15 |
| D. Reducing size of public sector | 23.7 | 34.5 | 22.7 | 10.3 | 8.8 | 3.55 |
| E. Redirecting national investment | 37.6 | 36.6 | 17.5 | 3.1 | 5.1 | 3.98 |
| F. Increasing competition | 44.3 | 39.7 | 11.8 | 2.1 | 2.1 | 4.23 |
| G. Heading for a more liberalized economy | 54.1 | 30.9 | 11.3 | 1.0 | 2.6 | 4.34 |

One can note that:

Managers' responses to this question support the conclusion made concerning managers' understanding of privatization (section 5.5.1). Many managers chose the main expected achievement of privatization as *'increasing efficiency of the public* *sector companies'* which reflects their expectation of their continuity. This response shows that managers either do not understand or do not accept the privatization policy and the inevitable reduction in SOEs. On the contrary they expect them to continue with an increase in their efficiency.

*'Widening the base of ownership through selling shares to the largest number'* was ranked fourth and *'reducing size of the public sector'* which is one of the major expected outcomes of the privatization policy was ranked sixth by the managers. This shows that according to many of them privatization does not necessarily mean selling SOEs or reducing the size of public sector companies.

Managers ranked *'heading for a more liberalized economy'* as third. It is worth mentioning that many of the managers had stated this as the meaning of privatization earlier.

Furthermore the following results can be deduced from the detailed results in Appendix D:

- 83.5% of the managers thought that increasing efficiency of the public sector was the most important (56.2%) or an important (27.3%) expected achievement of privatization. Only 10.3% were undecided, while 6.2% found it unimportant. This is rather surprising since it reflects the managers' expectations of continuity of the public sector.
- Widening the ownership base through selling shares to the largest number of small investors is also important (41.7%) from the point of view of many of the managers, 34.5% consider it important. However 23.8 % are either undecided or think it is unimportant. This shows that although many of the managers regard sale as one of the important consequences of privatization, some of them are still not sure about the significance of private ownership. This is also evident in section 5.5.1 discussing the meaning of the term privatization.
- When asked about the revenue earned by the Government the most frequent answer (26.8%) was undecided/neutral. 24.2% think that earning revenue is important. In general the responses to this statement varied. This is why the chi-square test has shown that there is a statistical difference within the total number of respondents and within the same groups in some cases from what one would expect on a chance basis. Differences attributed to whether the company is

industrial or not have proved to be insignificant, while those related to management level have been significant.

- Reducing the size of the public sector was found to be most important for 23.7%, important for 34.5%, neutral for 26.8% and either unimportant or least important for 30%. This answer reflects a misunderstanding of the privatization policy. This statement should have been the most important by most managers if they had correctly understood the meaning of privatization according to Government policy and its intended outcomes..
- The majority (74.2%) of managers agree that redirecting national investment is either a most important (37.6%) or an important (36.6%) possible achievement of privatization. Only 8.2% consider it unimportant.
- The majority (84%) of managers agree that increasing competition is either a very important (44.3%) or an important (39.7%) achievement. Only 4.2 % feel it is unimportant.
- The majority of responses (85%) to the statement *"heading for a more liberalized economy"* rate it as either most important or important while only 3.6% of the managers state that it is an unimportant achievement.
- The Chi-square tests for those five statements show that while statistical differences in distribution within the same groups have been found to be quite different from what would be expected on a chance basis in all cases, differences among the different groups have been found to be statistically insignificant (except in 'C' where differences between management levels were at 0.01). This means that the managers in all the groups expect different consequences for privatization. This could be explained by the fact that many of the managers understand privatization in different ways and accordingly they would expect different outcomes of the new policy.

Responses to this question again lead the researcher to question whether managers really understand or accept the privatization policy and the inevitable reduction in the number of SOEs. They reveal how managers expect SOEs to continue. They also show the necessity of further clarification of the privatization programme, its role and the expected outcomes to all involved.

### 5.4.4 Managers' Views about Drawbacks of Privatization (Q4)

Managers have been asked to indicate their views about the relative importance of possible drawbacks of privatization. A list of six drawbacks was presented to them and they were asked to determine the relative importance of each drawback. Managers were asked to state any other drawback they found important.

**Table 5.15: Managers' Views about Drawbacks of Privatization**

| Frequency % of Responses and Average Weights of Statements → | Very Important | Important | Neutral | Un-important | Not at all important | Weighted Average |
|---|---|---|---|---|---|---|
| A. The unemployment effects | 51.5 | 26.3 | 16.0 | 5.1 | 1.0 | 4.22 |
| B. Changing company policies | 24.7 | 26.3 | 23.7 | 14.4 | 10.8 | 3.4 |
| C. Possibility of changing managers | 13.9 | 26.8 | 28.9 | 17.5 | 12.9 | 3.12 |
| D. Private sector control and objectives | 19.1 | 21.6 | 22.2 | 13.9 | 23.2 | 2.80 |
| E. Privatization could be a threat to development plans | 13.9 | 25.8 | 16.0 | 18.0 | 26.3 | 2.83 |
| F. Privatization could be a threat to social justice | 24.2 | 31.4 | 14.4 | 19.1 | 10.8 | 3.39 |

One can note:

- Possible *'unemployment effects'* is ranked by the managers as the most important drawback of privatization and *'the possibility of changing managers'* as fourth. These responses show the importance of dealing with the human factor and reflect managers' fears of possible consequences of privatization. Knowing that privatization would only be desirable among managers if they feel secure about their jobs and careers, these fears -which could represent the main reason for managers' possible resistance to privatization implementation - should be taken seriously. Policies to soften the impact of unemployment (e.g. through redundancy packages and retraining) are necessary.
- *'Changes in company systems'* is ranked second by managers which reflects this factor's importance to many of them. Here one has to say that if some of

the managers still see these inevitable changes as drawbacks, then they would probably have a negative attitude to privatization.

- Some of the managers are also concerned that privatization could be a threat to national plans and social justice. Although this statement is given less weight than their fears of *'unemployment effects'* and of *'changes in company's systems'* it still shows the importance of these aspects in developing a plan for the different stakeholders.
- Adding *"private sector controls and objectives"* is also seen by some managers as one of the drawbacks of privatization. This shows that some of them still do not accept or desire private sector interference. Although this factor is ranked last by managers, the relatively high weight they give to it (2.8) shows that private sector authority is not desired by many.

Additionally, managers' detailed responses included in Appendix D show the following:

- Most managers (77.8%) agree that the unemployment effect is either of most important (51.5%) or important (26.3%). The Chi-square tests for this statement show that while statistical differences in distribution within the same groups are found to be quite different from what would be expected on a chance basis, in most cases (except among senior managers in industrial companies), differences among the different groups are statistically insignificant.
- Some managers (24.7%) consider *"changing company policies"* most important, while 26.3% find it important and 23.7% are undecided. Around 25.3% either feel it is unimportant or least important. The Chi-square test for this statement shows that statistical differences in distribution within the same groups are insignificant in most cases. Only in the total number of managers and in middle level managers the difference is significant. In all cases, differences among the different groups are statistically insignificant.
- Many managers (28.9%) are undecided about the extent of importance of *"the possibility of changing managers"*. Meanwhile 26.8% of the managers feel that this possibility is important while 13.9% feel it is very important and 12.9% feel it is least important. The Chi-square tests for this statement show that the statistical differences in distribution within the same groups are different from

what would be expected on a chance basis in most cases. Differences among the different groups are statistically insignificant in all cases.

- Opinions concerning the added authority of private owners as a drawback of privatization vary according to personal attitudes of managers. While 40.7% find it important or most important, 37.1% feel it is either unimportant or least important. The Chi-square tests for this statement show that statistical differences in distribution within the same groups are insignificant in most cases. Only in the case of non-industrial companies is the difference significant. In all cases, differences among the different groups are statistically insignificant.
- Further, 26.3% consider "*privatization could be a threat to development plans*" of least importance as a drawback of privatization. The Chi-square tests for this statement show that statistical differences in distribution within the same groups are insignificant in most cases. Only in the case of all managers and industrial companies are managers' views found different from what one would expect on a chance basis. In all cases, differences among the different groups are statistically insignificant.
- "*Privatization could be a threat to social justice*" is rated by most managers (24.2%), as most important or as an important (31.4 %) drawback of privatization. This statement reflects fear of the managers of the social side effects of privatization. This shows the necessity of clarification of the advantages of privatization in the long run and draws the attention to the importance of a mass media backing plan. The Chi-square test for this statement shows that statistical differences in distribution within the same groups is insignificant in some cases while there is no difference in others. Differences among the different groups are statistically insignificant in most cases, except in the case of managers categorized into senior and middle managers (at the level of 0.05).
- The statement that carried the highest frequency as an important drawback is the "*unemployment effects*". Possibility of changes in company systems and managers are also given high weights. This analysis reflects the fears managers have regarding implementation of privatization, emphasizing the necessity of developing tailored plans for managers, to increase their sense of security and of

developing absorption schemes for redundant labour and if possible for the unemployed.

### 5.4.5 Are Managers Really Looking Forward to Privatization (Q12)?

Acceptability of the privatization policy has been measured by using the following question:

*The privatization programme will take place over a number of years; do you think your company should have a priority in implementation?*

*A-Yes, Why?*

*B-No. Why not?*

Among the reasons managers mentioned for the affirmative answer were (table 5.16 B):

1- *The private sector is more capable of performing most activities affiliated* companies are responsible *for.*

2- *The public sector work force has been prepared to accept the policy of privatization.*

3- *In order to increase exports by producing high quality inexpensive products.*

4- *Existence of an investor who is ready to invest more money prevents or at least overcomes many problems and deficiencies of the public sector.*

5- *Accepting privatization is the only alternative, right now.*

6- *Privatization programmes include restructuring procedures and training programs, which will benefit the company.*

7- *The company already has "offered" stock in the stock market.*

8- *To achieve stability.*

9- *Our company is successful and is able to compete and prove itself whether public or private.*

10- *Ease of sale due to possibility of division.*

11- *Company production is based on personnel skills.*

12- *Broadening ownership base.*

13- *Creating liquidity.*

14- *No reason.*

✓ Reasons stated for choosing that their company should not have a priority of implementation in the privatization programme are (table 5.16 C):

*1- The company offers essential products for low, fixed government prices.*

*2- Our company is a strategic company.*

*3- The product we offer is a complementary product that feeds another public industry.*

*4- Public performance in this industry is satisfactory, or else the company is profitable, or it performs a service that is better done by the Government.*

*5- Privatization must be postponed until labour and liquidity conditions are adjusted in the company.*

*6- Company customers are limited and export opportunities are nearly nonexistent ; there is no chance for the private sector.*

*7- The private sector does not prefer this industry.*

*8- The company's market share is very low anyway, so it should not be a priority in the programme.*

*9- The private sector is better off starting a fresh new company.*

Responses of managers concerning their agreement to whether their company should have a priority in the privatization programme have been summarized in table 5.16A. The different reasons for their affirmative answers have been summarized and tabulated in table 5.16B. The different reasons for the negative answers have been summarized and tabulated in table 5.16C. The numbers in the top row of the tables B and C refer to the statement numbers mentioned above.

**Table 5.16 A: Responses of Managers Concerning their Agreement to Whether their Company Should Have a Priority in the Privatization Programme**

| Response → / Managers' Classification ↓ | | Yes | No | Un-defined | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|
| All managers | | 61.3 | 35.1 | 3.6 | 100.0 | 13.91*** | |
| Level of Manage-ment | Senior Mgmt. | 59.1 | 34.1 | 6.8 | 100.0 | 5.9 NS | 4.774 D.F=4 NS |
| | Middle Mgmt. | 63.2 | 35.8 | 0.9 | 100.0 | 8.18* | |
| Type of Business | Indus-trial | 70.9 | 29.1 | 0.0 | 100.0 | 39.79*** | 3.153 D.F=2 NS |
| | Non-In | 58.2 | 40.2 | 1.6 | 100.0 | 59.17*** | |
| Senior Managers Only | Indus-trial | 71.4 | 28.6 | 0.0 | 100.0 | 10.78* | 0.996 D.F=2 NS |
| | Non-In | 57.9 | 40.4 | 1.8 | 100.0 | 28.21*** | |
| Middle Managers Only | Indus-trial | 70.7 | 29.3 | 0.0 | 100.0 | 31.0*** | 2.037 D.F=2 NS |
| | Non-In | 58.5 | 40.0 | 1.5 | 100.0 | 32.84*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The following comments stem from the analysis of results:

- The majority of managers (61.3%) whether senior managers (59.1%) or middle level managers (63.2%), and whether in industrial companies (70.9%) or in non-industrial companies (58.3%) make the affirmative choice. In view of managers responses to previous questions this could be explained by the fact that many managers view privatization as increased autonomy and not sale of the company.
- Yet there is still a considerable percentage (35.1%), that prefers that their companies are not among the ones privatized in the next few years. This reflects a growing acceptance of privatization in principle among PE managers, but, in the short-term reluctance to face the uncertainties and threats posed by it.
- Asking managers for reasons behind their choices was complementary to this question. However, as shown in the tables many of the managers chose not to state their reasons.
- The Chi-square tests show that the distribution of all the managers within the same group is different in most cases from that which could be expected on a

chance basis. The case of senior managers in the categorization according to management level has been found to be insignificant. Differences due to the type of company and whether it is industrial or non-industrial have been found to be insignificant.

**Table 5.16 B: Reasons Managers Mentioned for Choosing that their Company Should Have a Priority in the Privatization Programme**

| Response → / Managers' Classification ↓ | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|---|
| All managers | | 1.5 | 1.0 | 1.0 | 3.1 | 4.1 | 8.8 | 0.5 | 3.6 | 8.8 |
| Manage-ment Level | S.M | 1.1 | 0.0 | 0.0 | 3.4 | 6.8 | 6.8 | 0.0 | 4.5 | 9.1 |
| | M.M | 1.9 | 1.9 | 1.9 | 2.8 | 1.9 | 10.4 | 0.9 | 2.8 | 8.5 |
| Type of Business | Indus. | 5.5 | 1.8 | 1.8 | 3.6 | 3.6 | 10.9 | 0.0 | 3.6 | 10.9 |
| | Non-Indus. | 0.0 | 0.8 | 0.8 | 3.3 | 4.9 | 9.0 | 0.8 | 2.5 | 9.0 |
| Senior Mgmt. Only | Indus | 7.1 | 0.0 | 0.0 | 0.0 | 14.3 | 7.1 | 0.0 | 0.0 | 0.0 |
| | Non Indus. | 0.0 | 0.0 | 0.0 | 5.3 | 7.0 | 8.8 | 0.0 | 3.5 | 14.0 |
| Middle Mgmt. Only | Indus | 4.9 | 2.4 | 2.4 | 4.9 | 0.0 | 12.2 | 0.0 | 4.9 | 14.6 |
| | Non Indus. | 0.0 | 1.5 | 1.5 | 1.5 | 3.1 | 9.2 | 1.5 | 1.5 | 4.6 |

Continued:

| Response → / Managers' Classification ↓ | | 10 | 11 | 12 | 14 | No Answer | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|
| All managers | | 0.5 | 1.5 | 1.0 | 35.1 | 27.3 | 100.0 | 245.2*** | |
| Manage-ment Level | S.M | 0.0 | 0.0 | 1.1 | 34.1 | 29.5 | 100.0 | 23.314** | 10.38 D.F=13 NS |
| | M.M | 0.9 | 2.8 | 0.9 | 35.8 | 25.5 | 100.0 | 109.07*** | |
| Type of Business | Inds | 0.0 | 3.6 | 0.0 | 29.1 | 20.0 | 100.0 | 30.33** | 16.347 D.F=13 NS |
| | Non In. | 0.8 | 0.8 | 1.6 | 40.2 | 24.6 | 100.0 | 131.66*** | |
| Senior Mgmt. Only | Inds | 0.0 | 0.0 | 0.0 | 28.6 | 28.6 | 100.0 | 6.84 NS | 13.528 D.F=9 NS |
| | Non In | 0.0 | 0.0 | 1.8 | 40.4 | 17.5 | 100.0 | 18.4* | |
| Middle Mgmt. Only | Inds | 0.0 | 4.9 | 0.0 | 29.3 | 17.1 | 100.0 | 19.2 NS | 16.24 D.F=13 NS |
| | Non In | 1.5 | 1.5 | 1.5 | 40.0 | 30.8 | 100.0 | 10.33 NS | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

**Table 5.16 C: Reasons Stated for Choosing that their Company Would Not Have a Priority of Implementation in the Privatization Programme**

| Response → / Managers' Classification ↓ | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | No answer | 14 | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All managers | | 3.6 | 5.7 | 0.5 | 3.6 | 8.8 | 1.0 | 1.0 | 1.0 | 13.9 | 60.8 | 100 | 72.4*** | |
| Management Level | S.M | 4.5 | 3.4 | 1.1 | 3.4 | 9.1 | 1.1 | 1.1 | 2.3 | 14.8 | 59.1 | 100 | 9.25 NS | 5.69 NS D.F=9 |
| | M.M | 2.8 | 7.5 | 0.0 | 3.8 | 8.5 | 0.9 | 0.9 | 0.0 | 13.2 | 62.3 | 100 | 19.06** | |
| Type of Business | Inds. | 3.6 | 5.5 | 0.0 | 5.5 | 3.6 | 1.8 | 3.6 | 0.0 | 7.3 | 69.1 | 100 | 3.87 NS | 10.909 D.F=9 NS |
| | Non -In. | 4.1 | 6.6 | 0.8 | 3.3 | 12.3 | 0.8 | 0.0 | 1.6 | 11.5 | 59.0 | 100 | 38.52*** | |
| Senior Mgmt. Only | Inds. | 0.0 | 7.1 | 0.0 | 7.1 | 7.1 | 0.0 | 7.1 | 0.0 | 0.0 | 71.4 | 100 | 1.25 NS | 8.236 D.F=9 NS |
| | Non Inds. | 7.0 | 3.5 | 1.8 | 3.5 | 12.3 | 1.8 | 0.0 | 3.5 | 7.0 | 59.6 | 100 | 12.04 NS | |
| Middle Mgmt. Only | Inds. | 4.9 | 4.9 | 0.0 | 4.9 | 2.9 | 2.4 | 2.4 | 0.0 | 9.8 | 68.3 | 100 | 1.35 NS | 8.886 D.F=7 NS |
| | Non Inds. | 1.5 | 9.2 | 0.0 | 3.1 | 12.3 | 0.0 | 0.0 | 0.0 | 15.4 | 58.5 | 100 | 19.93 | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

As evident from tables 5.16 B and 5.16 C, most managers chose not to answer (Choice 0) or to state that they didn't have a reason.

In table 5.16 B 8.8% of the total number of managers state their main reasons for choosing the affirmative answer is "*privatization programmes include restructuring procedures and training programmes, which will benefit the company.*" This reflects managers' desire for restructuring and reform of SOEs rather than divestiture. It could also be because managers recognize that restructuring is necessary before privatization.

An equal percentage (8.8%) of the total number of managers state "*the company already has 'offered' stock in the stock market*" as their reason. This shows that privatization would be easier to implement in companies that already have offered stock in the market.

In table 5.16 C 8.8% of the managers state that "*privatization must be postponed until labor and liquidity conditions are adjusted in the company*". This also shows managers' realization of the importance of restructuring and solving the labour dilemma before privatization takes place. Around 5.7% of the managers responded that their company is a "*strategic company*", which is the reason behind their choice.

Responses to this question have shown that the majority of managers chose that their company should have priority in implementation of the privatization programme. Yet, quite a large number of managers preferred that their company did not enter the programme in the next few years. Reasons for this could be reluctance to face changes, uncertainty or insecurity. It could also be explained by their realization of the necessary restructuring involved and the accompanying changes in management and work force, financial aspects and work systems.

### 5.4.6 Managers' Opinions about When it Would be More Appropriate to Implement Privatization (Q13)

Another question that was posed with an objective of measuring acceptability of privatization among managers inquired when they thought it was more appropriate to implement privatization in their own company. Managers were given five different alternatives to choose from. Table 5.17 presents their answers.

**Table 5.17: When Would it be More Appropriate to Implement Privatization from the Managers' Point of View?**

| Response → / Managers' Classification ↓ | | Right Away | Within a year | After five years | Later than that | Never | Total | $X^2_1$ | $X^2_2$ |
|---|---|---|---|---|---|---|---|---|---|
| All managers | | 7.7 | 19.1 | 38.7 | 14.4 | 20.1 | 100.0 | 51.5*** | |
| Level of Manage-ment | Senior Mgmt. | 8.0 | 18.2 | 35.2 | 12.5 | 26.1 | 100.0 | 20.9*** | 3.901 D.F=4 NS |
| | Middle Mgmt. | 7.5 | 19.8 | 41.5 | 16.0 | 15.1 | 100.0 | 34.8*** | |
| Type of Business | Indus-trial | 5.5 | 32.7 | 36.4 | 12.7 | 12.7 | 100.0 | 17.75** | 9.192 D.F=4 NS |
| | Non-In. | 9.0 | 13.9 | 41.0 | 14.8 | 21.3 | 100.0 | 38.25*** | |
| Senior Managers Only | Indus-trial | 7.1 | 28.6 | 42.9 | 7.1 | 14.3 | 100.0 | 6.71 NS. | 1.86 D.F=4 NS |
| | Non-In. | 8.8 | 17.5 | 35.1 | 12.3 | 26.3 | 100.0 | 13.09* | |
| Middle Managers Only | Indus-trial | 4.9 | 34.1 | 34.1 | 14.6 | 12.2 | 100.0 | 14.73** | 8.894 D.F=4 NS |
| | Non-In. | 9.2 | 10.8 | 46.2 | 16.9 | 16.9 | 100.0 | 29.385*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

It can be observed that:

- The most frequent answer (38.7%) is "after five years". This response shows that the respondents are not too eager about implementing privatization in their own companies. It could also be explained by their realization of the need for restructuring prior to sale.
- Actually 20.1% of the respondents prefer that the transfer of their company to the private sector would NEVER happen. Most probably those respondents would resist the implementation of privatization. When managers were categorized into senior and middle managers, 26.1% of senior managers and 15.1% of middle level managers made that choice. This shows that senior managers feel more threatened by the possible accompanying changes than middle managers. When categorized into industrial and non-industrial companies only 12.7% of managers

in industrial companies and 21.3% of managers in non-industrial companies made that choice. This reveals how managers of industrial SOEs recognize that industrial companies should be in the private sector.

- Only 7.7% of the total number of managers thought that privatization should take place right away. A speedy change is unwelcome by a vast majority of managers.
- The Chi-square tests show that the distribution of all the managers within the same group is different in most cases from that which could be expected on a chance basis. Only where managers have been categorized into senior and middle managers are the senior managers in industrial companies found to have insignificant differences. Differences due to the type of company and whether it is industrial or non-industrial are insignificant in all cases.
- Responses to this question contradict the managers' majority agreement that their company should have a priority in the privatization plan. This could be explained by the fact that managers see privatization implementation as reform and restructuring measures in many cases. Yet when asked when they think their company should be privatized many of them see no necessity for the rush and think it should be done within the next five years or even later. One-fifth of the respondents even went further to express their wish that *their* companies should never be privatized.

### 5.4.7 Managers' Attitudes Concerning Problems Hindering Implementation of Privatization (Q11)

Since managers are directly involved in the privatization implementation process, their attitudes towards obstacles hindering privatization need to be examined. Six possible problems were presented to them and they were asked to indicate the relative importance of each from their point of view.

This section presents managers' assessment of the importance of each factor from their points of view as summarized in table 5.18. Weighted average of each statement has been calculated in order to rank the importance of the different factors from their points of view. The table also shows the frequency percentage of the managers' different responses. The detailed results of their responses are included in appendix D in tables 6.A to 6.F where the Chi-square tests have been applied to measure the statistical significance in one group ($X_1^2$) and in two groups ($X_2^2$).

**Table 5.18: Managers' Views about the Extent of Importance of the Different Problems Possibly Hindering Implementation of Privatization**

| Frequency % of Responses and Average Weights of Statements → | Very Important | Important | Neutral | Un-important | Not at all important | Weighted Average |
|---|---|---|---|---|---|---|
| A. Labour resistance | 32.5 | 24.2 | 21.6 | 13.9 | 7.7 | 3.60 |
| B. Unavailability of sufficient information | 30.9 | 44.8 | 12.9 | 7.2 | 4.1 | 3.91 |
| C. Political resistance | 12.4 | 23.2 | 33.0 | 17.0 | 14.4 | 3.02 |
| D. Media disagreement | 9.3 | 21.6 | 30.9 | 23.2 | 14.9 | 2.87 |
| E. Prospective buyers low interest | 42.8 | 39.2 | 13.9 | 3.6 | 0.5 | 4.21 |
| F. Low income of the majority of the population limits the number of prospective buyers | 31.9 | 45.9 | 12.9 | 6.7 | 2.6 | 3.99 |

Based on the above table the following can be deduced:

- It is evident that managers judge lack of purchasing power to be the most challenging problem impeding privatization. They give the problem "*prospective buyers' low interest*" the highest weight followed by the factor "*low income of the majority of the population limits the number of prospective buyers*".
- The next problem managers identified was "*unavailability of sufficient information*". Inefficient communication is apparently a major hindrance to the privatization process. If the managers themselves who should communicate the information to their subordinates feel the insufficiency of information then the problem must be even worse at lower levels in SOEs.
- Labour resistance has been ranked fourth by managers as an obstacle to privatization. This shows that although managers do consider this factor important they do not perceive it as the most important problem. Such resistance can be overcome by adequate communication, incentives and support for workers and managers who might be made redundant.

- Political resistance has been given a low degree of importance by managers, presumably because the Government is in favour of privatization and is the instigator of the programme.
- Media disagreement has been given the least weight by managers.

Furthermore the detailed results included in appendix D show the following:

- Labour resistance was the first item that was tested to identify managers' opinions regarding the obstacles facing privatization. As shown in appendix D in table 6.A most managers felt that worker resistance was among the most important obstacles hindering implementation of privatization (57% of the managers found it to be important or most important). Since most of the resistance is probably out of fear of expected job losses, it is important to develop appropriate schemes for absorbing redundant workers who may be laid off.
- Unavailability of sufficient information concerning the new changes, at all levels, was another obstacle managers found important. Actually, 44.9% of the total managers responded it was an important obstacle while 30.9% found it very important. This reflects the need for a more efficient information system.
- The Chi-square tests for those two statements show that while statistical differences in distribution within the same groups were found to be quite different from what would be expected on a chance basis in all cases, differences among the different groups are statistically insignificant.
- Also 33% of the managers are undecided about the degree of importance of "the political factor" as an influencing factor in hindering privatization. The Chi-square tests show that statistical differences in distribution within the same groups are different from what would be expected on a chance basis in most cases except in differences related to whether the company is industrial or not. Differences between groups are statistically insignificant except in the management level case with a 0.05 level of significance.
- Managers are also undecided about "*influence of the media*" as a hindering factor. The Chi-square tests show that statistical differences in distribution within the same groups are different from what would be expected on a chance basis in most cases except in among senior managers in differences related to

whether the company is industrial or not. Differences between groups are statistically insignificant except in the case of differences according to management level with a 0.05 level of significance.

- The majority of managers believe that the "*unavailability of interest*" (82%) and "*lack of resources*" (77.8%) among potential purchasers are the most important factors hindering privatization implementation.
- The Chi-square tests for those two statements show that while statistical differences in distribution within the same groups are quite different from what would be expected on a chance basis in most cases, differences among the different groups are statistically insignificant.

## 5.5 Conclusion

The analysis in this chapter leads to the following conclusions:

❖ **Managers' Attitudes Concerning the Public Sector**

- Many managers thought that "*diversification of production and investment serving national development plans*" was the major objective of SOEs. Surprisingly, a large number of the managers mentioned profit making as one of these objectives. This response could be considered favourable to privatization, since SOE managers already consider profit making as one of the main objectives of their enterprises.
- When asked whether SOE objectives were attained, many managers admitted that public sector enterprises had either not achieved their objectives to a very large extent or not at all.
- Unexpectedly, many managers agree that "*public ownership guarantees high efficiency*" is the main reason why SOEs should stay in Public hands. "*Competition sometimes harms consumers while public monopolies don't*" is also mentioned as an important reason. Many of them also agree that '*the private sector might be greedy and not trustworthy*'. These answers show that many managers still see some advantages in continuity of Government

ownership and that many of them still do not believe in competition and do not trust the private sector.

- Most SOEs managers either disagree or strongly disagree with the accusations directed at SOE companies that they are inefficient and characterized by low productivity. This is not very surprising, since if they agreed with the statement they would be, at least partially, admitting to their own inadequacies. Yet, no reform could succeed without those managers and others, who are responsible for SOE performance, starting to admit their shortcomings and making improvements.
- *"Bureaucracy", "slow decision-making", "political influences on company" and "low management skills"* are among the most important reasons stated for low performance of SOEs from the managers' point of view. This could be considered a good sign for privatization since all these phenomena are usually related to Government ownership; they show their belief that changing this form of ownership would improve performance.
- There is overwhelming agreement that "*efficient marketing*" is among the most important success factors in economic enterprises. When managers were asked whether this factor was more evident in the private sector or the public sector, they admitted it was more evident in the private sector.
- These responses show how managers of SOEs themselves admit failure of SOEs to attain their objectives and how they think that important success factors in business enterprises are not sufficient in SOEs. These responses are favourable to privatization, since they reflect managers' belief that privatization would improve the performance of SOEs.

❖ **Managers' Views to Privatization and to Problems of Implementation**

- The managers' responses to the question related to the meaning of privatization have shown that although most managers agree that privatization is "*a drive towards a more liberalized economy*" many of them do not accept *selling* SOEs. This shows that many managers either do not understand or do not accept sale as an inevitable consequence of privatization.

- When asked directly about the extent of their agreement with the privatization policy, the majority of middle-level managers and top-level managers either agree or strongly agree with the new policy.
- When questioned about possible achievements of the privatization policy, many managers identify *"increasing efficiency of the public sector companies"* as the main expected achievement of privatization. This response reflects managers' expectation of continuity of SOEs. *"Widening the base of ownership through selling shares to the largest number"* is ranked fourth and *"reducing the size of the public sector"*, which is the major expected outcome of the privatization policy, is ranked sixth. This shows that according to many managers privatization does not necessarily mean selling SOEs, or reduction of SOEs but rather as reform measures that aim to increase efficiency. These answers again lead one to question whether managers really understand or accept the privatization policy.
- When managers' views concerning possible drawbacks of privatization were solicited the statement of *"unemployment effects"* was most frequently mentioned as an important drawback and *"possibility of changing managers"* was ranked fourth. This illustrates the importance of the human aspect in privatization. It reflects the concerns managers have regarding implementation of privatization.
- Next come the changes related to modifications in company systems. If some of the managers see these changes as drawbacks then their reasons should be studied carefully. Managers would not desire a system that they feel is full of drawbacks.
- Adding new private sector authority is also seen by some managers as one of the drawbacks of privatization. This shows that some of them still do not accept or desire private sector interference.
- Although the majority of managers respond that they agree to have their company among the priority companies in the privatization programme, yet, there is still quite a large number of managers, who prefer that their companies are not among the ones to be privatized during the next few years.
- Significantly, 20% of managers admit they wish their companies would never be privatized. Another 35 % mention that if they had the choice they would

prefer it after five years. This shows that many of the managers still have their doubts about the privatization policy and that a considerable number do not agree with it. Those who wish privatization would NEVER happen are likely to resist its implementation in different ways.

- Contradiction of the managers' responses as to their agreement that their company should have a priority in the privatization programme and their preference that their company shouldn't be privatized right away show that managers see privatization implementation as reform and restructuring measures and increased autonomy for them within the public sector, rather than the actual sale of SOEs.

### ❖ Managers' Opinions About Problems Possibly Hindering Implementation of Privatization

- The majority of managers rate the unavailability of purchasing power as the most challenging problem impeding privatization. Thus, in their opinions, lack of demand is the main problem that could slow down the sale of SOEs. It may be noted that experience with IPOs before the completion of this study proved quite the opposite. Demand for shares in SOEs put on sale have exceeded supply at times, by a factor of 10 to 15.
- Labour resistance comes next in the managers' assessment of obstacles to implementation of the privatization programme. This indeed is a major problem that needs to be tackled effectively.
- The next most important problem, according to the managers, is the lack of information available to them. This is a serious drawback warranting more efficient communication to cover all stakeholders.
- Perhaps rather surprisingly political resistance was not considered an important problem by the majority of managers. This should make the implementation easier and commitment higher.

The following chapters will be devoted to an assessment of each of the main problems and requirements for effective implementation of privatization in Egypt. The assessments will be based on evidence from interviews, case studies, factual information and managers' attitude surveys.

# Chapter Six

## Adequacy of the Legal Framework

### 6.1 Introduction

The legal and institutional framework within which SOEs operate is often a major obstacle to privatization and changes in the legal framework are normally required prior to privatization. This is why the researcher has found it necessary to examine the adequacy of the legal framework which is a basic component in the proposed 'good' practice model. In Egypt several laws were initiated to manage and direct the economy to a more liberalized system of which privatization is an important pillar. Among these were Law 203[1] organizing the SOEs, Law 95 managing the Stock Exchange and the new financial laws which constitute part of the fiscal reform. This chapter is devoted to studying the sufficiency of Law 203/1991 governing Public Enterprises. Having described it briefly, the chapter investigates whether the new law has succeeded in creating a favourable setting for privatization or has it in any way caused an obstacle to smooth implementation and what the managers' views concerning this aspect are.

Most analysts have agreed that for privatization to be easier to undertake and to yield better financial results, a more market-friendly, competitive environment should be introduced (Kikeri et al, 1992). This is why privatization is usually more successful when it is introduced as part of an integrated reform plan that ensures that this condition exists. A well-defined legal framework is especially important to prepare the environment for the implementation of privatization. The different legal measures should be able to encourage the private enterprise to develop while protecting the legitimate interests of consumers, competitors and taxpayers (Galal et al, 1995).

In Egypt many preparatory efforts were undertaken to help make the environment ready for successful privatization. These efforts were summarized in Chapter Three (Reform Efforts) and in Chapter Four (Preparing for Privatization).

[1]Law203/ 1991 was issued to replace Law 97/1983. The new law's effectiveness in dealing with drawbacks of the previous law is discussed in Section 6.4.

Most of those efforts were directed to establishing a legal framework that is more adequate for implementation of privatization. The main objective is to change the economy into a more market-oriented one. In this Chapter the researcher concentrates on the managerial aspects of the new Law 203 discussing its adequacy from an analytical point of view including attitudes and views of top management executives.

## 6.2 Legal Aspects of Privatization: Why?

Legal issues are major pillars of the privatization process from the preparation phase to implementation (Kikeri et al, 1992). The legal framework exists primarily at two levels: the systemic (laws, regulations and institutions) and the transaction levels (Guislain, 1992).

In the preparation phase of privatization existing legislation, as well as, the legal status of the SOE(s) to be privatized must be examined to decide whether they allow privatization and are compatible with the Government's objectives. Laws may need to be changed or introduced to enable and initiate the privatization process, regulate the concerned sectors, strengthen the country's capital markets or authorize the transfer of the concerned SOE(s) to the private sector. In some cases SOEs may have a legal status that does not allow or does not facilitate divestiture in which case a status change will be required. In Egypt, for example, until recently it was forbidden by law to sell or divest any public sector company. Also if the ownership of assets is disputed, the rights of conflicting parties could only be clarified through a well-established legal system. All these factors need to be addressed before privatization is actually implemented successfully.

During the implementation stage lawyers will also be needed to draft and advise buyers and sellers on the selling negotiations. Their advice will be needed to help both parties to understand and implement the new legal framework and to settle any conflicts during the implementation phase.

Even after finalizing the privatization transaction, legal measures are essential to ensure that all parties follow the terms agreed upon. If any of the parties fails to do so, the legal framework must include effective recourse mechanisms that enforce remedies. As the World Bank reports (Kikeri et al, 1992):

*"The range and complexity of legal issues that could arise in privatization programmes is almost endless. In each country, and for each transaction, privatizing governments should retain the services of qualified experienced and independent lawyers to help them in identifying critical legal issues and providing solution."*

## 6.3 A Summary of Major Developments Introduced by Law 203/1991

As mentioned before Law 203/1991 was issued to replace Law 97/ 1983 which previously governed the public sector in Egypt. It was issued as an intermediate step towards full implementation of Law 159/1981 governing private sector corporations. Its main objective was to organize the privatization process as a step towards full liberalization.

Major developments introduced by the new law could be categorized into two main groups (Moursy, 1993): one group concerns enhancing performance of the PEs and the other group aims to encourage private sector investment in PEs. Below is a summary of the most important improvements introduced by the new law.

### 6.3.1 Managerial Aspects Introduced by Law 203 Aiming to Create a more Appropriate Environment for Enhancing Public Sector Performance

Several managerial aspects were added by Law 203 in order to enhance public sector performance and make it more attractive for private investment. These changes are summarized as follows (Moursy, 1993):

- The new law left the Public Enterprise role, to be specified by each individual company according to its initial, economic and commercial terms of reference and objectives. Each SOE is to act as a separate legal entity managing its investments in its own best interest regardless of the government's social and political objectives. This more economic role is vastly different from the old attitude of managing SOEs for social and political objectives.

- The new law exposed the public enterprises to market forces. For the first time the Government was allowed to divest and sell loss-making units or companies. The law also required equal treatment of public and private sector companies in financial aspects and banking matters.
- Several new items were also added by the new law concerning provisions and distributed profits encouraging the PEs to be more dependent on their own resources. One of the most important additions is stopping the compulsory distribution of bonuses to employees in loss making companies.
- The new law liberalized the formation of the Board of Directors (BOD) of holding and affiliated companies from bureaucratic interference of the Government. The new law stressed the importance of efficiency and experience rather than seniority in choosing members of the BOD.
- The new law added several rules regulating workers' participation in management. It also laid several foundations for developing performance evaluation and incentive systems in order to ensure more flexibility and efficiency.

### 6.3.2 Improvements Aiming to Facilitate Private Sector Investment

Other changes were also introduced to allow and facilitate private sector investment in SOEs. The main changes are (Moursy, 1993):

- For the first time in thirty years public sector companies were authorized to sell their stock in affiliated companies. The new law allowed private sector participation in affiliated companies owned by the Government up to a maximum of 49%, with no change of HCs' ownership status[2]. This adjustment allowed the SOEs to retain ownership while attracting private sector investments in an effort to strengthen their financial structures or to inject new blood in management.
- Stock owned by the Government can now be traded in the Stock Market.
- Permission for selling shares owned by the public sector was granted even if the sale results in reducing public ownership to less than 50%.

[2]If private sector participation exceeds this limit it would then be changed into a joint stock company.

## 6.4 Effectiveness of Law 203/1991 in Dealing with Drawbacks of Law 97/1983

This section is devoted to summarizing the major drawbacks of Law 97/1983 and how Law 203 has tackled them (Fahmy, 1992).

### 6.4.1 Mixing Ownership with Management

One of the most evident weaknesses of Law 97/1983 was mixing ownership with management. This resulted in excessive Government interference in starting SOEs, forming their Boards of Directors and interference in strategic and management functions.

- According to the previous law, SOEs were supervised by public authorities, which were separate Government entities established by presidential decrees to represent the government in supervising each related group of companies. These entities were replaced by "Holding Companies" governed by commercial law representing Government ownership of affiliated companies' stocks. Their major task is management of the Government stock portfolio in affiliated companies without interference in the affiliated companies' strategic and management functions.
- In the previous law the BODs of the public authority (a government organization) was composed of Chairmen of the companies it supervises (maximum of five companies), a representative of the labour union and a maximum of four experts in the field. This meant that the directors of the affiliated companies who were outnumbering the experts supervised themselves. The new law abolished this practice. It forbade Chairmen or Directors of affiliated companies from participating in BODs of holding companies. Instead, it ruled that the BODs of HCs be mainly composed of experts in economic, financial, technical, business administration and legal matters (at least five members) and one representative of the general federation of the Trade Unions (syndicates) and a full-time chairman. The law states that the BODs are to represent Government ownership in HCs and should not be managers of the affiliated companies.

- Contrary to the present law, the public authority in the previous law was owned by the Government, with no stock or shareholders. This made it easier for the Government to interfere directly in the management of PEs.
- According to the new law, HCs and ACs may be divided and amalgamated either by a decree of the Prime Minister, based upon a proposal by the concerned minister, or by a resolution of the BODs of the company or HC with the approval of the general assemblies. This could be regarded as an important simplification of amalgamation, division, dissolution and liquidation procedures of HCs and ACs.
- Formation of BODs of the ACs also changed in accordance with the new law. Before, the number of BOD members in wholly owned SOEs were chosen from within the company (usually senior managers) to represent Government ownership. In SOEs with private shares, the BOD was composed in proportion to the ownership interest under the condition that the number of members representing the private sector could by no means exceed the number representing the public sector, whatever the proportions of ownership might be. According to the new law the BOD of wholly owned ACs is headed by a part-time chairman plus 50% part-time experts employed by the HC's BOD and of an equal number of elected workers who need not be senior managers in the company (Article 21). This reflects the inclination of Law 203 to efficiency, expertise and employee representation rather than seniority in company management. The same is evident in companies with private ownership, excepting that the number of elected members has to equal the number of members representing the public and private sectors together (Article 22). Another difference is that choosing the AC's CEO is left for the Head of the HC General Assembly, who is the Chairman of the HC, instead of the whole General Assembly of the holding company as in wholly-owned ACs.
- Composing AC General Assemblies (equivalent to shareholders meetings in private corporations) also changed according to the new law. In the previous law the General Assembly was chaired by the concerned Minister (or a deputy he identifies), and was mainly composed of representatives of the Ministries of Finance, Planning, Commerce and Economy, workers in the company and representatives of the private sector in case of partial private sector ownership.

Under the new law the General Assembly of the AC is composed of the BOD plus specialized experts in case of wholly Government-owned ACs, or private sector representatives (replacing experts) in case of private participation in ownership. In both cases the Chairman of the HC heads the General Assembly (Articles 25 and 26).

- The new law also introduced improvements allowing the dismissal of the BOD of PE companies in case of low performance. The prior law limited this right to the minister,. without giving the BOD any chance to defend itself, but allowed the BOD members to receive their salaries and incentives during the dismissal period and get re-employed in the same company afterwards even if they were inefficient. Articles 5 (concerning HCs) and 29 (concerning ACs) changed this. They ruled that dismissal could be demanded by the General Assembly if the BOD fails to achieve its objective and abolished the Minister being the sole decision maker in this respect. Article 29 also gave the Board the right to explain and defend itself to the General Assembly but forbade members receiving salaries during dismissal or being re-employed in the same company afterwards if inefficiency was proved.

### 6.4.2 Forbidden Transfer of Public Sector Shares

- The most important reform in Law 203 is allowing the sale of stock owned by the Public Sector, even if public ownership decreases to less than 51% of the company (Article 2). This was completely forbidden by Law 97. The new law gave the BOD of the HC the right to sell up to 49% of the stock it owns in ACs. If it was to sell more than 49%, which changes the majority of the company, the decision has to be made by the head of the HC's General Assembly, who is the concerned minister. This adjustment allowed the public sector to get rid of loss making companies and unproductive assets for the first time. It also gave SOEs the right to retain ownership while attracting private sector investments in an effort to restructure its finances or to inject new blood in management. Yet, it made these steps dependent on the minister's willingness to go ahead with them.

### 6.4.3 Predetermined Profit Distribution and Different Funds and Reserves

- According to the previous law it was the task of the Government (more precisely the Cabinet) to determine how much of the annual profits was to be kept for funds and reserves. These funds usually amounted to around 17.5% of the company's net income and the General Assembly (GA) and BOD of the company did not have the authority to decide anything concerning them.
- After deducting the reserves, only the Prime Minister had the authority to decide how the annual profits would be distributed, under the condition that those working in the company would receive a minimum of 25% of what stockholders receive. The Prime Minister also had the right to determine a part of the profits that would be transferred to a fund from which the workers in loss making companies received their bonuses (Articles 41, 43). This arrangement had an adverse effect in both loss making and profit making companies. The work force in loss making companies knew they would get their profits anyway, so why work and at the same time the work force in the profit making companies knew the profits would be taken anyway, so why exert additional effort?
- All this was changed by Law 203 (Articles 34, 40). The GA and the BOD became the main decision-makers on reserves and profit distribution according to company circumstances. There are no longer obligatory funds or reserves or compulsory transfers to losing companies. Workers are to receive profits only if their companies make profits (whatever the reasons for their losses were) with a minimum of 10% and a maximum equal to their total annual salaries. After deducting the annual funds and reserves and the worker profits, the rest of the profits are distributed among the shareholders.
- The new system of distributing profits forces the SOE to seek covering its needs through its own resources. It also creates incentives for workers to produce more in an effort to make their companies realize more profits. This should positively influence performance of SOEs.

## 6.4.4 Other Issues Addressed by Law 203/1991

- Article 47 in Law 97/ 1983 stated that "it was forbidden to declare bankruptcy of an SOE under any condition". This gave managers of loss making companies an unnecessary protection that allowed them to continue with losses and increasing debts. This was addressed in Articles 38 and 39 of Law 203 that allowed declaration of bankruptcy of HCs or ACs in some cases, especially if their losses exceed 50% of their issued capital. This is to be decided by the General Assembly which also has the right to keep the company working if the shareholders decided that the losses could be overcome by adopting new policies or systems.
- Law 203 also stopped the unlimited credit lines and debts[3] that the previous law allowed based on guarantees from the Public Authorities (Article 8 / 8). Such debts were usually not returned and the banks had to return to the Public Authority for collection, which was against economic rules. It is worth mentioning here that these debts amounted to L.E 742.5 million for the period 1978 to 1986/87. The new law required SOEs to comply with the same conditions and guarantees for credit lines as private companies.
- The new law made new rules to regulate transferred allocations from the State to SOEs, which forced PEs to depend on their own resources.
- According to Law 97 all SOE workers were to be treated according to Law 48/1987 regardless of the special circumstances of each company. The new law gave more flexibility to the HCs and the ACs in deciding their labour policies (Articles 42 and 43). The policies of SOEs are to be determined by the management according to each company's circumstances subject to the condition that labour wages are not less than the legal minimum and that the incentives and bonuses are to be related to efficiency and profitability.

## 6.5 Drawbacks of Law 203/1991

Although Law 203/1991 has successfully identified and tackled many of the weaknesses in Law 97/1983, it still has some major drawbacks, which are identified below (Fahmy, 1992).

- Law 203 appoints the concerned Minister as Head of the General Assembly of the HC and determines the number of the first General Assembly (12 members), regardless of the special circumstances of each individual company. It also advises the employment of a representative of the Ministry of Finance on the holding company's Board of Directors, whenever possible. This reflects a continuity of the bureaucratic spirit in the HC's BOD and General Assembly and still retains some important controls in the hands of the Government.
- Although the new law did stress the principle of expertise in composing the BODs of the ACs, which is considered a major improvement, it left the number of elected technical workers on the Board equaling 50%, which contradicts this principle. It also did not distinguish between companies that have a private share and those that do not. This means that in a company with private ownership (even if it reached the maximum allowed limit under government control of 49% private ownership) the proportion of workers added to the members representing the public ownership on the Board, will in many cases exceed the proportion of private representation. This will undoubtedly affect the private sector's desire to buy shares in SOEs.
- The Chairman and part-time experts of the AC are either recruited by the AC General Assembly headed by the Chairman of the HC (in the case of wholly Government-owned ACs) (Article 25), or else directly headed by the Chairman of the HC himself (in case of private sector partial ownership). In both cases the Chairman of the HCs who was recruited on his behalf by the Minister, has the upper hand in choosing the BOD of the ACs. This implies that if the Minister succeeds in choosing an efficient HC Chairman, this would also be reflected on the ACs but if this was not the case then both the holding company and the ACs will be inefficient. This rule could also result in continuing patronage. More

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[3]Most of these debts were from the four major Public Banks.

objective criteria should be used to guarantee correct choice of BOD without any danger of favouritism.

- Another drawback is the lack of clarity of the tasks of BODs of ACs which have important strategic management and operational functions under the new law. The law only specifies the tasks of BODs of HCs (Article 6), which mainly manage the Government's stock portfolio.
- In case of proven inefficiency and dismissal of members of a BOD, the law still allows employment of the dismissed person in another SOE. Restrictions have to be enforced so as not to repeat problems of one company in another.
- Although the new law prohibits distributing bonuses to employees and workers in loss making companies, it includes generous profit distribution to workers, a minimum of 10% and a maximum of 100% of their salary, in profit making companies regardless of the extent of the profit made. Distribution of profit to shareholders can only come from the remainder after payment of these bonuses and deduction for resources and funds. This might not be very appealing to private investors who expect to realize profits proportional to the profit the company makes. Further, if the profits were not sufficient to cover the 10% minimum distribution of workers' bonuses, a problem of financing profit distribution would arise. Another disadvantage of the article is that the workforce would only have the incentive to *start making* profit rather than *maximize* it, since there is a minimum they would get even if profits were less and a maximum they cannot exceed even if profits were more.
- Another important issue left unclear is the law an Affiliated Company should follow if more than 51% of its equity is transferred to the private sector. Would it follow Law 159/1981 directing private corporations or Investment Law 230/1989 directing joint companies? Also, if it is left unspecified as it is, who should be the decision-maker in each case?
- The law has not clearly identified ways of dealing with problems of past performance, e.g. past debts.
- The law did not consider the issue of dealing with redundant labour, especially in units that are being prepared for sale.

## 6.6 Are the Changes in the Legal Framework Sufficient?

The changes introduced in the legal environment were useful in creating a more favourable setting for privatization, but are still insufficient. The more important improvements are:

- Divestiture and sale of public enterprises was allowed for the first time.
- Permitting sale of Government shares in SOEs.
- Stopping compulsory distribution of profits to personnel working in loss-making companies.
- More autonomy was given to SOEs to manage their own affairs independently of the social and political objectives of the Government.

Yet there still remain some drawbacks which have been indicated above. These drawbacks could hinder the implementation of privatization of individual companies by slowing down their restructuring in preparation for privatization. The managers' views on this issue are considered in the following section.

## 6.7 Managers' Attitudes Regarding the Legal Framework

In this section attitudes of managers and their opinions about different aspects of the new law are examined. Self-administered questionnaires were distributed among senior and middle managers in industrial and non-industrial companies. The objective was to solicit their views concerning major drawbacks of the previous Law 97/1983 and whether Law 203 succeeded in overcoming them. Managers were also encouraged to express their own views about the changes they felt were needed to enhance the effectiveness of the new law to create a more favourable environment for smooth implementation of privatization.

### 6.7.1 Managers' Attitudes Concerning the Drawbacks of Law 97/1983 (Q21)

Managers were asked to identify what in their opinions the major drawbacks of Law 97/1983 were. The most frequent answers were as follows:

*1- Either no drawbacks or tolerable drawbacks.*

*2- Government interference and affiliation to ministries.*

*3- Numerous control bodies.*

*4- The old law worked in an atmosphere of directed economy and central planning that took many social and political aspects into consideration (e.g. the law that ensures a Government job for every university graduate, products were priced on social bases, etc.)*

*5- The law lays out many restrictions and rules for establishing Boards of Directors that have proved to be inappropriate in many cases (e.g. the rule that necessitates election of workers representing 50% of the Board of Directors).*

*6- Labour law, promotion system, recruitment, incentive and punishment rules all need to be reviewed.*

*7- Centralization and limited authority of decision making at various management levels, (inflexibility and limited authority of setting work rules in the different departments double the problem).*

*8- Countless problems.*

*9- Bureaucracy.*

*10-. The law made many problems more complicated concerning financial systems , wages and incentives.*

*11- Vagueness of responsibility and authority limits, contradictions and limitations of complementary measures and rules are major drawbacks.*

*12- Non-existent boundary between ownership and management .*

*13- Concentrating on production and neglecting marketing and hence on productivity rather than need.*

*14- Absence of ownership control and, in many cases, deficiencies in planning , control and evaluation.*

*15- The system allows for accumulating debts and debt interest.*

*16- Absence of accountability enhanced low performance and laziness.*

Managers' most frequent responses are summarized and tabulated in table 6.1 where the figures in the top row refer to the most frequent of the above responses. The Chi-square Test indicates the statistical significance of all the differences between subgroups of managers.

**Table 6.1: Managers' Opinions Concerning Major Drawbacks of Law 97/1983**

| Responses → / Managers' Classification ↓ | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 1.0 | 7.2 | 1.0 | 4.1 | 5.2 | 1.0 | 11.3 | 5.7 | 1.0 |
| Manag-ement | S.M | 0.0 | 5.7 | 1.1 | 4.5 | 5.7 | 0.0 | 12.5 | 4.5 | 1.1 |
| | M.M | 1.9 | 8.5 | 0.9 | 3.8 | 4.7 | 1.9 | 10.4 | 6.6 | 0.9 |
| Company | Indust. | 0.0 | 1.8 | 0.0 | 9.1 | 7.3 | 0.0 | 12.7 | 9.1 | 1.8 |
| | Non-Indust. | 1.6 | 9.8 | 1.6 | 2.5 | 4.9 | 1.6 | 12.3 | 4.9 | 0.8 |
| Senior Manage-ment | Indust. | 0.0 | 0.0 | 0.0 | 21.4 | 7.1 | 0.0 | 7.1 | 7.1 | 7.1 |
| | Non-Indust. | 0.0 | 7.0 | 1.8 | 1.8 | 7.0 | 0.0 | 17.5 | 5.3 | 0.0 |
| Middle Manage-ment | Indust. | 0.0 | 2.4 | 0.0 | 4.9 | 7.3 | 0.0 | 14.6 | 9.8 | 0.0 |
| | Non-Indust. | 3.1 | 12.3 | 1.5 | 3.1 | 3.1 | 3.1 | 7.7 | 4.6 | 1.5 |

**Continued: Managers' Opinions Concerning Major Drawbacks of Law 97/1983**

| Responses → / Managers' Classification ↓ | | 10 | 13 | 14 | 16 | 0 | 21 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 1.0 | 0.5 | 1.0 | 1.0 | 53.6 | 0.5 | 100.0 | 730.2*** | |
| Level of Manag-ement | S.M | 1.1 | 0.0 | 0.0 | 2.3 | 52.3 | 1.1 | 100.0 | 108.83*** | 14.069 D.F=14 NS |
| | M.M | 0.9 | 0.9 | 1.9 | 0.0 | 54.7 | 0.0 | 100.0 | 334.85*** | |
| Type of Business | Indust. | 1.8 | 0.0 | 3.6 | 1.8 | 49.1 | 0.0 | 100.0 | 158.7*** | 17.154 D.F=14 NS |
| | Non-Indust. | 0.8 | 0.8 | 0.0 | 0.8 | 50.8 | 0.8 | 100.0 | 400.6*** | |
| Senior Manag. Only | Indust. | 7.1 | 0.0 | 0.0 | 7.1 | 42.9 | 0.0 | 100.0 | 16.65NS | 17.003 D.F=10 NS |
| | Non-Indust. | 0.0 | 0.0 | 0.0 | 1.8 | 43.9 | 1.8 | 100.0 | 91.04*** | |
| Middle Manag. Only | Indust. | 0.0 | 0.0 | 4.9 | 0.0 | 51.2 | 0.0 | 100.0 | 111.65*** | 14.958 D.F=12 NS |
| | Non-Indust. | 1.5 | 1.5 | 0.0 | 0.0 | 56.9 | 0.0 | 100.0 | 219.0*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

- By far, the most frequent answer regarding the major drawback of the previous law is *"centralization and limited authority of decision making at various management levels, (inflexibility and limited authority of setting work rules in the* *different departments doubles the problem)*". The new law has sought to deal with those problems as indicated earlier.

- The second most frequent answer was the *'many restrictions and rules for establishing Boards of Directors'* in SOEs. Some of the managers have mentioned several problems regarding this issue that need to be addressed, e.g. the 50% worker participation, but this has not been changed by the new law as indicated earlier.
- The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. The differences related to level of management and whether the company is industrial or non-industrial have proved to be statistically insignificant in all cases.
- Responses to this question have shown the numerous drawbacks of Law 97/1983. Some of them have been addressed while others need further effort in order to make the new framework more complete.

## 6.7.2 Managers' Assessment of the Extent to which Law 203/1991 Solved the Drawbacks of Law 97/1983 (Q22)

One of the main criteria for deciding the effectiveness of Law 203/1991 is examining whether the new law succeeded in overcoming problems of the previous one blamed for low performance of the Egyptian public sector. Managers' opinions about how far the problems of Law 97/1983 were solved by Law 203 have been examined using the following question:

*To what extent do you think those drawbacks were solved, by the new Law 203?*

*A- To a large extent*

*B- To some extent*

*C- Not at all*

Managers' responses are summarized and tabulated in the following table (table 6.2) where the letters in the top row refer to each of the above responses. The Chi-square Test indicated the statistical significance of all the differences between subgroups of managers.

**Table 6.2: Managers' Opinions Concerning the Extent that Law 203 Solved Problems of Law 97/1983**

| Responses → / Managers' Classification ↓ | | A | B | C | 0 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|
| All Managers | | 8.8 | 45.9 | 19.6 | 25.8 | 100.0 | 56.6*** | |
| Management Level | S.M | 13.6 | 47.7 | 12.5 | 26.1 | 100.0 | 28.6*** | 8.624* |
| | M.M | 4.7 | 44.3 | 25.5 | 25.5 | 100.0 | 33.4*** | D.F=3 |
| Type of Business | Indust. | 12.7 | 41.8 | 20.0 | 25.5 | 100.0 | 10.06*** | 1.577 |
| | Non-Indust. | 7.4 | 48.4 | 18.9 | 25.4 | 100.0 | 43.64*** | D.F=3 NS |
| Senior Manag. Only | Indust. | 21.4 | 57.1 | 0.0 | 21.4 | 100.0 | 9.43* | 2.44 |
| | Non-Indust. | 14.0 | 47.4 | 12.3 | 26.3 | 100.0 | 17.72** | D.F=3 NS |
| Middle Manag. Only | Indust. | 9.8 | 36.6 | 26.8 | 26.8 | 100.0 | 6.094 NS | 4.603 |
| | Non-Indust. | 1.5 | 49.2 | 24.6 | 24.6 | 100.0 | 29.495*** | D.F=3 NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The following observations can be made:

- Although many managers (46%) agreed that Law 203/1991 solved the drawbacks of Law 97/1983 to some extent, a large percentage (20%) of them thought that the new law did not solve the drawbacks at all. Only 9% of the managers felt that the drawbacks were solved to a large extent.
- The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. The differences related to level of management and whether the company is industrial or non-industrial have proved to be statistically insignificant in all cases except in the case of dividing the managers into senior and middle-level managers where they were statistically significant.
- Managers' responses to this question confirm the conclusion made in the previous question. As key informants in SOEs many managers think that the new law only solved the drawbacks of the previous law to a limited extent. This could be a result of the insufficiency of the Law 203/1991 or because of limited implementation 'so far'.

### 6.7.3 Managers' Opinions Concerning What the New Law Added or Changed (Q.16)

In an effort to solicit the managers' views about what Law 203/1991 added or changed, they were asked to answer the following open-ended question:

> *Law 203/1991 was a major Government step towards privatization. In your opinion, what did the new law add or change?*

Among the different managers' responses to what the most important changes made by the new law were, the following were the most common:

*1- Possibility of rent and sale of production units, creating liquidity that could be used in restructuring the company or paying its debts.*

*2- Limiting the control bodies in charge of the public sector.*

*3- The new law allows management to work with the private sector mentality. It also gives management decision-making authorities and encourages creativity.*

*4- Equality among the public and the private sector work forces (similar treatment on redundancies and profit sharing).*

*5- Broadening the ownership base and allowing the private sector to invest in public sector activities.*

*6- Enforcing the use of the scientific management approach in PE companies and canceling privileges the public sector used to enjoy, e.g. unlimited credit lines. (The new law established rules and limits to unlimited credit lines forcing public sector companies to depend on their actual resources, to restructure their financial structures and to deal with their losses).*

*7- Liberalizing public sector companies from the interference of the Government and the different Ministries and drawing* *a line between Government social role and its economic role.*

8- *Development of the recruitment system especially in higher levels of management.*

9- *Applying the principle of seperating management from ownership.*

10- *The new system is not clear yet.*

11- *No change or at least we haven't actually felt the difference.*

12- *Liberalizing public sector companies from bureaucracy whether in systems or in rules .*

13- *Creation of a system of holding and affiliated companies and accountability according to performance.*

14- *Increasing competition and encouraging the business public sector to improve its performance.*

15- *Haphazard changes in the Board of Directors of different companies creating a sense of insecurity and negative psychological pressure.*

16- *Options in question (17)(see section 5.6.2).*

17- *Allowing holding companies to interfere in affiliated companies' work, with no clear limitations to their authority.*

18- *Canceling privileges the public sector used to have.*

Managers' responses are summarized and tabulated in the following table (table 6.3) where the figures in the top row refer to each of the above responses. The Chi-square test indicates the statistical significance of all the differences between subgroups of managers.

**Table 6.3: Managers Attitudes Concerning What Law 203/1991 Added**

| Responses → / Managers' Classification ↓ | | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 35.1 | 2.1 | 2.1 | 3.1 | 1.0 | 1.5 | 5.2 | 10.3 | 1.0 | 11.3 |
| Level of Manage-ment | S.M. | 30.7 | 2.3 | 3.4 | 0.0 | 1.1 | 2.3 | 3.4 | 17.0 | 1.1 | 13.6 |
| | M.M | 38.7 | 1.9 | 0.9 | 5.7 | 0.9 | 0.9 | 6.6 | 4.7 | 0.9 | 9.4 |
| Type of Business | Indus. | 20.0 | 1.8 | 3.6 | 0.0 | 1.8 | 3.6 | 1.8 | 9.1 | 1.8 | 18.2 |
| | Non-Indus. | 33.6 | 2.5 | 1.6 | 4.9 | 0.8 | 0.8 | 7.4 | 12.3 | 0.8 | 9.0 |
| Senior Manag. Only | Indus. | 21.4 | 0.0 | 7.1 | 0.0 | 0.0 | 14.3 | 5.3 | 21.1 | 1.8 | 14.0 |
| | Non-Indus. | 14.0 | 3.5 | 3.5 | 0.0 | 1.8 | 0.0 | 0.0 | 21.4 | 0.0 | 21.4 |
| Middle Manag. Only | Indus. | 19.5 | 2.4 | 2.4 | 0.0 | 2.4 | 0.0 | 2.4 | 4.9 | 2.4 | 17.1 |
| | Non-Indus. | 50.8 | 1.5 | 0.6 | 9.2 | 0.6 | 1.5 | 9.2 | 4.6 | 0.0 | 4.6 |

**Continued:**

| Responses → / Managers' Classification ↓ | | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 4.6 | 10.8 | 5.7 | 2.6 | 2.1 | 0.5 | 0.5 | 0.5 | 100 | 111.1 | |
| Level of Manage-ment | S.M. | 4.5 | 12.5 | 6.8 | 1.1 | 0.0 | 0.0 | 1.8 | 0.0 | 100 | 42.0*** | 24.59 |
| | M.M | 4.7 | 9.4 | 4.7 | 3.8 | 3.8 | 0.9 | 0.0 | 0.9 | 100 | 232.68*** | D.F=17 NS |
| Type of Business | Indus. | 9.1 | 14.5 | 7.3 | 0.0 | 3.6 | 0.0 | 2.4 | 1.8 | 100 | 49.65*** | 24.33 |
| | Non-Indus. | 3.3 | 10.7 | 5.7 | 4.1 | 1.6 | 0.8 | 0.0 | 0.0 | 100 | 219.22*** | D.F=17 NS |
| Senior Manag. Only | Indus. | 5.3 | 7.1 | 0.0 | 0.0 | 4.9 | 0.0 | 2.4 | 2.4 | 100 | 7.45 NS | 13.58 |
| | Non-Indus. | 7.1 | 17.5 | 10.5 | 1.8 | 3.1 | 1.5 | 0.0 | 0.0 | 100 | 35.39** | D.F=12 NS |
| Middle Manag. Only | Indus. | 9.8 | 17.1 | 9.8 | 0.0 | 9.8 | 0.0 | 2.4 | 2.4 | 100 | 35.93*** | 39.401** |
| | Non-Indus. | 1.5 | 4.6 | 1.5 | 6.2 | 3.1 | 1.5 | 0.0 | 0.0 | 100 | 253.82*** | D.F.= 17 |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The table shows the following:

- About 35% of the sample chose not to answer this question. Another 11% found that the changes were insignificant. This could be interpreted either by a low degree of understanding of the law, or by their expectations of no real changes in day-to-day work. It could also be because the new law has not been fully implemented, which might have made the managers feel that there had been no changes.

- The most frequent response (11.3%) was "*applying the principle of seperating management from ownership*", which reflects managers' awareness of the importance of this principle.
- "*Liberalizing public sector companies from the interference of the Government and the different ministries and drawing a line between the Government's social role and its economic role*" was another frequent response (10.3%).
- The Chi-square test shows that the distribution in answers, in the same group is in most cases different from what one would expect on a chance basis. This reflects the different managers' views concerning the most important change the new law has added. The open-ended question that has been used makes these differences more evident, since it does not limit the respondents' choice of responses.
- Respondents in non-industrial companies found that the most important changes were:
    - *The new law allows management to work with a private sector mentality. It also gives management decision making-authorities and encourages creativity (9.2%).*
    - *Enforcing the use of the scientific management approach in PE companies and canceling privileges the public sector used to enjoy, e.g. unlimited credit lines (9.2%).*

At the same time middle level managers of industrial companies considered "*applying the principle of separating management from ownership*" the most important change (17.1%). Surprisingly, an equal number of managers thought that the new law did not add or change anything.

- Responses to this question suggest that senior managers are more aware of the law as would be expected, also confirmed by statements 9 and 7. This could be because senior managers are more directly affected by the law. The responses also show the importance of communicating the new law to different managers, especially middle-level managers in industrial companies.

## 6.7.4 Managers' Attitudes towards the Degree of Importance of Some of the Changes Introduced by Law 203 (Q17)

To assess the importance of the different changes introduced by Law 203, from the managers' points of view, they were asked to indicate the importance of each of nine statements that were presented to them. The respondents were also asked to indicate any other changes they thought were important. Weighted averages have been used to rank the importance of these changes from the managers' points of view.

Table 6.4 summarizes managers' responses on the degree of importance of some of the changes introduced by Law 203/1991. The table shows the frequency percentage for each of the responses and the weighted average for each statement. The detailed tables are included in appendix D.

**Table 6.4: Managers' Attitudes towards the Degree of Importance of Some of the Changes Introduced by Law 203**

| Response Frequency % and Average Weight → / Statement | Very Important | Important | Neutral | Un-important | Not at all important | Weighted Average |
|---|---|---|---|---|---|---|
| A. Creating a system of holding and affiliated companies. | 20.6 | 33.0 | 21.1 | 16.5 | 8.8 | 3.40 |
| B. Liberalizing affiliated companies from routine and Government interference. | 53.6 | 27.3 | 10.3 | 4.1 | 4.6 | 4.21 |
| C. Creating an atmosphere of competition enhancing efficiency. | 54.1 | 28.9 | 9.3 | 4.1 | 3.6 | 4.26 |
| D. Changing public sector companies into "Public Enterprises" | 23.2 | 31.9 | 20.1 | 11.9 | 12.9 | 3.41 |
| E. Development of management choice criteria to a more effective system. | 47.9 | 30.4 | 10.3 | 5.1 | 6.2 | 4.09 |
| F. Certifying the principle of separating management and ownership | 50 | 27.3 | 10.8 | 6.7 | 5.1 | 4.09 |
| G. Assigning the control function to a single organization (The Central Auditing Agency) | 31.4 | 33.0 | 22.7 | 4.6 | 8.2 | 3.74 |
| H. Permission to sell public sector companies | 33.0 | 38.1 | 19.1 | 6.7 | 2.1 | 3.95 |
| I. Equality in treatment between business and public sector companies | 40.2 | 34.5 | 13.4 | 5.7 | 6.2 | 3.96 |
| J. Others | 0.05 | 0.5 | 98.5 | 0.5 | 0.0 | 3.01 |

According to weighted averages the ranking of statements is as follows:

*1. Creating an atmosphere of competition enhancing efficiency.*

*2. Liberalizing affiliated companies from routine and Government interference.*

*3. Certifying the principle of separating management and ownership.*

*4. Development of management choice criteria to a more effective system.*

*5. Equality in treatment between business and public sector companies*

*6. Permission to sell public sector companies*

*7. Assigning the control function to a single organization (The Central Auditing Agency)*

*8. Changing public sector companies into "Public Enterprises"*

*9. Creating a system of holding and affiliated companies.*

The weighted averages show that the most important change introduced by Law 203 as perceived by the managers is *"creating an atmosphere of competition"*. Managers have also given very high ratings to *"liberalizing company systems from Government interference"* and *"equality of treatment with the private sector."*

Permission to sell shares in SOEs has been rated as sixth amongst the most important changes. This shows that managers either do not believe that this will happen or that its effects will be insignificant for them.

Changes related to company systems such as changing public sector companies to public enterprises and creating a system of holding and affiliated companies have been given the least importance by the managers, which shows that managers do not really feel changes in their actual work from this change.

Tables (5.A to 5. J) in appendix D also show the following:

- Most managers agreed that " *creating an atmosphere of competition enhancing efficiency*" was the most important change introduced by the new law [54.1% of the respondents ranked it as the most important change and 28.9% ranked it as important].
- *"Liberalizing affiliated companies from routine and Government interference"* was nearly equally supported by managers. As shown, 53.6% ranked it as the most important change and 27.3% thought it was important.

- The next important change according to the managers was *"development of management choice criteria to a more effective system"*. Around 78% felt it was either the most important (47.9%) or an important change (30.4%).
- *"Certifying the principle of unrelated management and ownership"* was given nearly the same importance as the previous statement. Here 50% ranked this as most important and 27.3% thought it was important.
- *"Assigning the control function to 'the Central Auditing Agency', **a single controlling organization**"* was also viewed by many managers (31.4%) as most important or important (33%). This probably reflects the fact that this change directly affects managers in their work. Surprisingly only 20.6% found changing the system to HCs and ACs was very important while 25.3% felt it was either an unimportant or the least important change. Also, only 23.2% thought that changing the company into a "Public Enterprise Company" was very important. Meanwhile, 24.8% found this change unimportant or the least important. In both cases around 30 % found the change important. This illustrates that the managers have not felt actual changes in their work.
- *"Permission to sell public sector companies"* was also not given the importance that was expected. Around 71% thought that it was most important (33%) or important change (38.1%) introduced by the law. Around 19.1% of the respondents were neutral.
- *"Equality of treatment between business and public sector companies"* was perceived as the most important change by 40.2% of the managers and as an important change by 34.5% of them.
- In all cases the Chi-square tests show that the distribution of all the managers is different from that which could be expected on a chance basis. The Chi-square tests have also shown that the differences related to level of management and whether the company is industrial or non-industrial have proved to be statistically insignificant in most cases. The difference is statistically significant for the statements D

(table 5.D) and G (table 5.G) where there has been a significant difference in the views of 'middle managers only' in industrial and non-industrial companies. The difference is also significant (at the 0.01 level) between senior and middle managers, in the case of statement C (table 5.C).

In general managers' responses to this question show that enhancing competition and a more liberalized atmosphere are the most important changes that have been introduced by the new law, but at the same time they did not feel any changes related to their daily work.

### 6.7.5 Managers' Attitudes towards Expected Results of Law 203/1991 (Q18)

Managers were asked to indicate the expected results of the new law. Five options were presented to them and they were encouraged to add any other results they would expect. The question used was:

*What are the expected results of the new law in your opinion?*

*A- Better performance in public sector companies.*

*B- An increase in the number of public sector companies.*

*C- A decrease in the number of public sector companies.*

*D- No change.*

*E- Other results (please specify).*

The managers' answers are summarized and tabulated in table (6.5)

**Table 6.5: Managers' Attitudes Concerning the Expected Results of Law 203/1991**

| Responses → / Managers' Classification ↓ | | A | B | C | D | 0 | E | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 58.8 | 3.1 | 25.3 | 10.3 | 2.1 | 0.5 | 100 | 296.7 | |
| Mngmt .Level | S.M | 68.2 | 4.5 | 18.2 | 6.8 | 2.3 | 0.0 | 100 | 178.3 | 9.492 |
| | M.M | 50.9 | 1.9 | 31.1 | 13.2 | 1.9 | 0.9 | 100 | 132.0 | D.F=5 |
| Type of Business | Indust. | 56.4 | 5.5 | 29.1 | 9.1 | 0.0 | 0.0 | 100 | 75.19 | 4.97 |
| | Non-Indust. | 61.5 | 1.6 | 23.0 | 9.8 | 3.3 | 0.8 | 100 | 188.96 | D.F=5 |
| Senior Manag. Only | Indust. | 71.4 | 14.3 | 7.1 | 7.1 | 0.0 | 0.0 | 100 | 23.86 | 5.81 |
| | Non-Indust. | 73.7 | 1.8 | 17.5 | 3.5 | 3.5 | 0.0 | 100 | 107.3 | D.F=4 |
| Middle Manag. Only | Indust. | 51.2 | 2.4 | 36.6 | 9.8 | 0.0 | 0.0 | 100 | 59.24 | 3.24 |
| | Non-Indust. | 50.8 | 1.5 | 27.7 | 15.4 | 3.1 | 1.5 | 100 | 66.55 | D.F=5 |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The table shows the following main results:

- Managers (58.8%) consider *"better performance in public sector companies"* the most important expected result of the new law. This answer shows how managers expect that the changes would be more related to restructuring and reform and enhancing performance of SOEs rather than divestiture. This either reflects a misunderstanding of the whole policy or a refusal of acceptance of what is behind it. It suggests that managers believe that the law will be more effective in enabling restructuring than divestiture.
- The next important expected result according to the managers has been *"a decrease in the number of public sector companies"* (25.3%). Inevitable as it is, this result was only chosen by 25.3% of the managers who represent less than half of the ones that chose better performance of SOEs. However, the expected shrinkage of the public sector seemed to be more accepted by middle managers (31.1%) than by senior managers (18.2%).
- Another surprising response was that 10.3% of the managers expected no change at all resulting from implementing the new law. This again reflects lack of communication or their expectation that the law would not be implemented actively or effectively.

### 6.7.6 Extent of Managers' Agreement as to whether some of the Problems were left Unsolved by Law 203/1991 (Q.19)

To identify managers' extent of agreement to whether some of the problems have been left unsolved by the law, four statements were presented to them and the extent of their agreement with each was solicited.

Managers' responses are presented in table 6.6. The extent of their agreement/disagreement has been indicated in the top row. Weighted averages have been used to rank these statements from the managers' point of view[4]. Detailed results are included in appendix D (tables 7.A to 7.D). The tables also include results of the Chi-square tests.

**Table 6.6: Extent of Managers' Agreement as to whether some of the Problems were left Unsolved by Law 203/1991**

| Frequency % of Responses and Average Weight of Statements → | Strongly Agree | Agree | Neutral | Disagree | Strongly Disagree | Weighted Average |
|---|---|---|---|---|---|---|
| A. Blurred responsibilities between holding and affiliated companies. | 29.4 | 26.3 | 12.9 | 23.7 | 7.7 | 3.47 |
| B. Authority of decision making is still in the hands of the Government. | 25.3 | 34.5 | 15.5 | 19.6 | 5.1 | 3.54 |
| C. The new law does not include ways of dealing with problems created by performance (e.g. past debts). | 56.2 | 26.3 | 8.2 | 7.7 | 1.5 | 4.28 |

According to the weighted averages managers' extent of agreement as to whether some of the problems were left unsolved by the new law could be summarized as follows:

1. *The new law does not include ways of dealing with problems created by performance (e.g. past debts).*

2. *Authority of decision making is still in the hands of the Government.*
3. *Blurred responsibilities between holding and affiliated companies.*

As evident, most managers have agreed that "*not including ways to deal with problems of past performance (e.g. past debts)*" was the most important problem that was left unsolved by Law 203/1991. They have also given high ratings to the fact that decision making is still in the hands of the Government. Many of them also agreed that blurred responsibilities between ACs and HCs is another problem.

Furthermore, one can note the following observations from tables 6A to 6C in appendix D:

- There was overwhelming agreement that "the new law does not include ways of dealing with problems of past performance e.g. past debts." (83% either strongly agreed or agreed). This illustrates the importance of addressing past performance problems, especially that in most cases these problems continue to affect the future performance of the company.
- Around 55.7% of managers either strongly agreed or agreed that the division of responsibilities between HCs and ACs was blurred. This reflects low communication and ambiguity of the law to those who have to work under it. More than half the respondents felt that the authority of decision making was still in the hands of the Government (59.8%).
- The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. The differences related to level of management and whether the company is industrial or non-industrial have proved to be statistically insignificant in all cases except in the case of senior managers in industrial and non-industrial companies.

Finally managers' responses have generally shown that there are still a number of issues that have not been sufficiently addressed by Law 203/1991. Further improvements are still required to complete the development of the legal framework accompanying privatization.

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[4]Strongly agree=5, agree=4, neutral=3, disagree=2 and strongly disagree=1

### 6.7.7 Managers' Views about Possible Changes that Could be Added to Law 203/1991 (Q.20)

Managers' views about possible changes that could be added to Law 203/1991, to make it more effective, have been identified using the following open-ended question.

*If you had the authority to change the new law to what you think is more practical or useful, what changes would you propose?*

In some cases managers chose not to answer, and in others they made one or more suggestions. Answers are summarized, coded and tabulated in table (5.4). The key to the different responses is:

*0- No answer*

*1- No change*

*2- Adjusting the rules that govern the creation of the Boards of Directors in the Pubic Enterprise Companies. A fixed percentage of 50% of workers on the Boards of Directors is no longer appropriate. Other options could be setting a lower limit to the number of workers on the Board, confining it to the president of the labor union or even making it depend on election results, with no restrictions. Another suggestion was making the General Manager or the Financial Manager appointed on the Board.*

*3- Prohibiting interference of HCs in ACs' internal affairs. There must also be a direct relationship between the Chairman and the production sectors.*

*4- Liberalizing top management in dealing with labour.*

*5- Choosing top management according to past performance and abolishing permanent committees for choosing managers.*

*6- Abolishing it right away and using the existing law for the private sector; one law for all companies.*

*7- Changing the attitude towards public sector companies' capital as public money with no owner. This necessitates restructuring companies' financial structures, accounting systems and controlling systems especially from the Central Accounting Agency. Outstanding debts also* *have to be dealt with. The government should hold onto the minimum of 51% ownership in important industries only.*

*8- Restructuring labour laws.*

*9- Giving employees the full option of early retirement without losing any of their financial rights. Companies could be responsible for the difference in pensions due to early retirement especially when the reduction of labour force is needed for restructuring.*

*10- Choosing the Board of Directors from those actually working in the company and reviewing their work annually.*

*11- Defining authorities in the companies more clearly leaving no space for misunderstanding; Clarifying the relationship between the Chairman and the CEO.*

*12- Adjusting the compensation system of the work force and of higher levels of management to introduce appropriate incentive systems.*

*13- Increasing permitted private sector ownership.*

*14- Stopping the HC system.*

*15- Return to the law 97\1983.*

*16- Giving management free hand for restructuring and making them accountable for results.*

*17- Stopping Government interference.*

*18- Returning companies to their initial owners before nationalization (denationalization).*

*19- Development of control bodies and unifying them.*

*20- Applying the law in a more serious manner.*

Managers' responses are summarized and tabulated in the following table (table 6.7) where the figures in the top row refer to each of the above responses. The Chi-square Test indicates the statistical significance of all the differences between subgroups of managers.

**Table 6.7: Managers' Views about Possible Changes that Could be Added to Law 203/1991**

| Responses → / Managers' Classification ↓ | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 4.1 | 8.2 | 2.1 | 4.6 | 3.6 | 1.5 | 3.6 | 4.1 | 1.0 | 2.6 | 0.5 | 1.0 | 1.5 |
| Mgmt. Level | S.M | 0.0 | 14.8 | 2.3 | 5.7 | 3.4 | 1.1 | 5.7 | 2.3 | 0.0 | 2.3 | 1.1 | 1.1 | 1.1 |
| | M.M | 7.5 | 2.8 | 1.9 | 3.8 | 3.8 | 1.9 | 1.9 | 5.7 | 1.9 | 2.8 | 0.0 | 0.9 | 1.9 |
| Type of Bus-iness | Indust. | 5.5 | 5.5 | 0.0 | 1.8 | 5.5 | 0.0 | 3.6 | 9.1 | 3.6 | 5.5 | 0.0 | 0.0 | 1.8 |
| | Non-Indust. | 4.1 | 10.7 | 3.3 | 6.6 | 2.5 | 2.5 | 4.1 | 2.5 | 0.0 | 0.8 | 0.8 | 1.6 | 1.6 |
| Senior Manage. Only | Indust | 0.0 | 21.4 | 0.0 | 0.0 | 0.0 | 0.0 | 7.1 | 7.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| | Non-Indust. | 0.0 | 17.5 | 3.5 | 8.8 | 3.5 | 1.8 | 7.0 | 1.8 | 0.0 | 1.8 | 1.8 | 1.8 | 1.8 |
| Middle Anage Only | Indust. | 7.3 | 0.0 | 0.0 | 24 | 7.3 | 0.0 | 2.4 | 9.8 | 4.9 | 7.3 | 0.0 | 0.0 | 2.4 |
| | Non-Indust. | 7.7 | 4.6 | 3.1 | 4.6 | 1.5 | 3.1 | 1.5 | 3.1 | 0.0 | 0.0 | 0.0 | 1.5 | 1.5 |

**Continued**

| Responses → / Managers' Classification ↓ | | 14 | 15 | 16 | 17 | 18 | 19 | 20 | 0 | 21 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 0.5 | 1.0 | 3.6 | 0.5 | 1.0 | 0.5 | 3.1 | 49.5 | 1.5 | 100 | 936.7*** | |
| Manag. Level | S.M | 1.1 | 1.1 | 4.5 | 0.0 | 1.1 | 0.0 | 2.3 | 47.7 | 1.1 | 100 | 165.42*** | 25.852 D.F=21 |
| | M.M | 0.0 | 0.9 | 2.8 | 0.9 | 0.9 | 0.9 | 3.8 | 50.9 | 1.9 | 100 | 463.35*** | |
| Type of Business | Indust. | 0.0 | 1.8 | 3.6 | 1.8 | 0.0 | 1.8 | 3.6 | 45.5 | 0.0 | 100 | 208.4*** | 27.744 NS D.F= 21 |
| | Non-Indust. | 0.8 | 0.8 | 4.1 | 0.6 | 1.6 | 0.0 | 3.3 | 45.9 | 2.5 | 100 | 497.64*** | |
| Senior Mana. Only | Indust. | 0.0 | 7.1 | 7.1 | 0.0 | 0.0 | 0.0 | 0.0 | 50.0 | 0.0 | 100 | 45.58*** | 10.717 D.F=17 |
| | Non-Indust. | 1.8 | 0.0 | 5.3 | 0.0 | 1.8 | 0.0 | 3.5 | 35.1 | 1.8 | 100 | 106.85*** | |
| Middle Manag. Only | Indust. | 0.0 | 0.0 | 2.4 | 2.4 | 0.0 | 2.4 | 4.9 | 43.9 | 0.0 | 100 | 77.31*** | 24.312 D.F= 19 |
| | Non-Indust. | 0.0 | 1.5 | 3.1 | 0.0 | 1.5 | 0.0 | 3.1 | 55.4 | 3.1 | 100 | 331.19*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The analysis of the table shows:

- Nearly 50% of the respondents did not answer. This could possibly be because they did not feel qualified to make an assessment.
- The most frequent response (8.2%) was *"adjusting the rules that govern the creation of the Board of Directors in the Pubic Enterprise*

*Companies"*. Managers felt that *"a fixed percentage of 50% of workers on the Boards of Directors is no longer appropriate."* Among the options the managers proposed was *"setting a lower limit to the number of workers on the Board, confining it to the president of the labour union or even making it dependent on election results with no restrictions."* Another suggestion frequently mentioned was *"letting the General Manager or the Financial Manager participate on the board"*.

- Managers responses show that there was a clear difference between senior and middle managers in the types of suggestions. This mainly reflects the greater concern of senior managers with strategic issues and of middle managers with operational and personnel issues. More senior managers proposed *"adjusting rules governing creation of BODs in SOEs"* more frequently than middle managers. The same applied to *"liberalize top management in dealing with labour"* and *"changing the attitude towards public sector companies' capital as public money with no owner."* On the other hand, more middle *managers proposed "restructuring labour laws"* as compared to senior managers. This reflects middle managers' concerns about issues in which they were involved directly.
- The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis.
- Responses to this question have highlighted several shortcomings of the present legal framework accompanying privatization. Among the most important necessary developments managers have proposed is abolishing the 50% workers participation in BODs rule. Completion of such issues would increase attractiveness of SOEs for private sector investment, creating a more favourable environment for implementation of privatization.

## 6.8 Conclusion

❖ **General**

One of the main steps essential for implementation of privatization is creating an appropriate legal environment for privatization to take place. The effectiveness of this legal framework depends on how actively it is used and whether its provisions are adequate for the purpose. It should also be clear that the law is enabling, whether it has a significant impact depends on implementation and enforcement.

In the Egyptian context several laws were initiated to make necessary adjustments. The law most related to privatization is Law 203/1991 governing PEs. The law introduced several developments and has successfully tackled some of the weaknesses of the previous Law 97, creating a more favourable environment for privatization. Yet the law has some problems that still remain to be addressed:

- Dealing with past debts.
- Blurred responsibilities.
- Labour responsibilities and laws (e.g. the 50% worker participation in the BODs).
- SOEs that sell more than 51% of their shares and do not know which law to follow.
- Continuity of Government interference in PEs (apparent in the necessity of participation of a representative of the Ministry of Finance in the HC's BOD).
- Determining pre-set minimum and maximum profit distribution levels for the SOE workforce.

❖ **Managers' Attitudes**

Responses of managers show that many of them had not felt the impact of applying the new law in SOEs. Managers, especially senior managers, feel restructuring and performance improvement are the most important effects of applying Law 203/1991. Although they perceive increased competition as one of the outcomes of the new law, they seem to be skeptical about the extent of divestiture.

In general, managers' responses to questions related to Law 203/1991, a major pillar of the legal framework required for privatization, have reflected ambiguity of the law to many of the managers. This could either be a result of slow enforcement, ineffective communication or a reflection of reluctance to accept the expected changes, which are in many cases inevitable. It is also evident that managers still find several shortcomings that need to be addressed.

# Chapter Seven

# Restructuring

## 7.1 Introduction

The end of central planning and the adoption of the open-door policy in the Seventies made SOEs face the real market for the first time. SOEs became exposed to strong competition with imports. Their production was no longer isolated from international markets. At no time the dormant problems causing inefficient performance became more evident to all. Ineffective solutions, large state subsidies, unlimited credit lines from state banks helped hide some of the problems for some time, but only to let them explode in the Eighties. The vicious circle of SOEs' losses, deteriorating state banks portfolios and increasing Government liabilities had to be faced. The economic liberalization policies adopted in the Egyptian Economic Reform Programme in the Nineties were the answer. Budget constraints, large reductions in State subsidies and termination of unlimited credit followed. Restructuring SOEs and State banks became part of an integrated approach aiming for a market-oriented economy through implementation of privatization.

As shown in the "good" practice model, adequacy and success of these restructuring efforts are a pre-requisite for successful privatization. Although planned at the industry level restructuring is implemented at the enterprise level, which makes coordination and efficient communication between the two levels essential. It also means that many problems of implementation can arise between the planning and implementation stages. This chapter is devoted to studying how the Egyptian Government tackled the problem of restructuring SOEs and whether there have been problems in implementing restructuring. It also compares restructuring measures in Egypt with generally accepted restructuring measures outlined in the privatization literature based on experience elsewhere.

This chapter, first, discusses a few terms related to restructuring. It then briefly discusses the relationship between successful reform and restructuring. The following sections are devoted to studying the Egyptian case. Performance of SOEs is briefly presented first with a discussion of the main causes of SOEs' inefficiency. The

Government restructuring programme is then described followed by the researcher's comments. Loss-making SOEs' performance after seven years of restructuring is then outlined, followed by the Minister's explanation of some aspects. Managers' attitudes about different aspects of restructuring obtained from the survey are then summarized. Finally, a case study of one of the loss making companies undergoing restructuring as part of the Government restructuring programme is included to provide insights into more detailed aspects of restructuring in a specific case.

## 7. 2 On Defining Restructuring

A restructuring operation (PEO, 1994) is defined as a set of actions intended to restore the sustainable technical, economic and / or financial viability of a company. Viability will generally be achieved when a company has shifted to a product mix and a cost structure that are competitive and will remain Ð so.

More elaborately, the restructuring process (Afify, *1991*) could be described as a process of change aiming to reform technical and financial structures of a firm to enable it to successfully pursue its task. Introducing changes in the company's range of products, increasing production and productivity, as well as rationalization of costs are options the company can follow as required.

Basically there are two main approaches (Borish et al, 1995) for reform of State Owned Enterprises (SOEs). One of them is centralized at the Government level while the other is decentralized at the enterprise level depending mainly on banks. Government-led restructuring is a "centralized" approach in which the Government takes the lead in restructuring SOEs financially, physically and operationally through multiple institutional channels (Dhar et al, 1994). The bank-led approach assumes that banks are instruments of financial restructuring of enterprises and vehicles for indirect physical and operational restructuring, as well. Countries have increasingly depended on a mixture of both approaches. In this case procedures like hard budget *constraints* on banks and SOEs are taken side by side with encouraging decentralized bank restructuring efforts (Borish et al, 1995).

The nature and degree of a restructuring operation depend on the nature and size of the problems facing the company (Vuylsteke, 1988). A company can be sound from the technical, strategic and operational points of view but may be suffering from financial troubles. If the distortions are removed, the company needs only to undergo a financial restructuring to restore its economic and financial viability. In general, other limited restructuring actions are also necessary. These kinds of restructuring operations could be named "financial and limited restructuring operations".

"Comprehensive restructuring", on the other hand, is when the problems confronting the company are more profound, requiring changes in strategy, technology, organization, management and/or manpower. It is obvious that comprehensive restructuring includes financial restructuring as a basic component.

In general, SOEs in need of restructuring could be categorized into two main groups:

- a group that needs financial restructuring (writing-down of Assets, re-capitalization, spinning off of assets and debt restructuring) ; and
- a group that needs more comprehensive measures (physical rehabilitation, manpower and management restructuring).

Among the most common restructuring techniques used are corporatization and utilization of internal and external incentive structures to reform troubled companies (Muir, 1995). In some cases there is no other option than divestiture or liquidation of at least part of the enterprise, so restructuring takes place as a step towards partial or total divestiture. Corporatization of SOEs means organizing the SOEs along the lines of enterprises in the private sector in the hope of achieving similar levels of efficiency and profitability. This option is preferred by many countries and has been tried in Egypt several times. Internal organizational and governance incentives include the internal structures and arrangements between the owner and the corporate managers by which the owner directs and monitors actions taken to attain the goals set by the owner. External incentives include variables relating primarily to market factors which, while not under the direct control of owners, discipline managers and owners in performance. Divestiture could be used as an effective option leading to restructuring (Shirley, 1989).

## 7.3 Relationship between Economic Reform and Institutional Restructuring

The World Bank discussion Paper (Borish et al, 1995) "Restructuring Banks and Enterprises" summarizes the most important conditions for effective restructuring as follows:

- The willingness and ability of governments to impose hard budget constraints on loss-making banks and enterprises to promote the larger objectives of macroeconomic stabilization, fiscal balance and economic growth.
- The pace of systemic transformation in the economy, namely speed of enterprise and bank privatization to improve management, governance and overall performance.
- Institutional capacity, legal and regulatory frameworks, bank supervision and financial sector infrastructure to improve the enabling environment.
- Centralized and decentralized solutions to work out loan portfolios, restructure loss-making enterprises and develop the human capital and market conditions needed for a competitive banking environment.

These factors show the complementary roles of reform measures at the national level and restructuring of SOEs and banks. Only if this integration is effective could privatization be successful in the long term. Restructuring of the different SOEs and banks would promote better allocation of resources. If this is achieved together with creating a supportive environment for entrepreneurial development, encouraging competition and developing capital markets, a more favourable environment for implementation of privatization would be ensured (Shirley, 1989).

## 7.4 The Most Common Elements in Successful Enterprise Reform Programmes

According to the World Bank Report "Improving State Enterprise Performance" (Shirley, 1989) the most common elements of all enterprise reform programmes include simultaneous actions aimed at:

- Introducing into SOE reorganizations attributes of the modern corporation, for the purpose of achieving commercial objectives.
- Introducing competition from the private sector international sources, and between SOEs in product and labour markets.
- Cutting direct and indirect financial subsidies from government to SOEs.
- Reforming the financial sector, including upgrading prudential regulations and banking supervision systems so that the financial sector might be able to provide the necessary external incentives and discipline.
- Separating the role of owners (i.e. Government) from the day-to-day management of SOEs while also minimizing the number of bureaucratic layers between the company and the Government, e.g. in a large state, allowing provincial bodies to represent their owner interests without interference from the central Government.
- Unbundling non-core businesses from the SOEs.
- Transferring many of the social functions from the enterprise to municipal or central Government Authorities.
- Introduction of necessary social safety net, including pension system and unemployment services.
- Revision of state functions through the creation of an ownership neutral policy regulatory framework for commercial enterprises, removing distortions (price controls) and correcting disincentives (tax policy and administration) for greater equity and efficiency.

At the enterprise level, another study identifies the main aspects of reform of the institutional framework as follows (Shirley, June 1989):

- Setting well – defined goals for SOEs, which can be transformed into measurable and manageable targets.
- Giving managers the freedom (sufficient autonomy) to act and hence to be answerable for results achieved.
- Selecting efficient people to run the commercial venture and paying them well.
- Managers are held responsible for results achieved including rewards and sanctions.

## 7.5 Do Egyptian SOEs Need Restructuring?

One of the most important objectives of the privatization programme is enhancing public sector asset-utilization efficiency. As evident from table 7.1, there is a substantial number of loss-making PEs that need restructuring. The GOE is faced by two options: either to restructure them before they are offered for privatization which would make them more attractive to private investors or to transfer them to the private sector *as they are* leaving the burden of restructuring to the new owners. Benefit-cost analysis of restructuring in each individual case would help the GOE to reach such decisions.

**Table 7.1: Development of Public Enterprise Financial Results**

*Million Pounds*

| Statement | 1990-1991 Before Law 203/1991 | 1991-1992 | 1992-1993 | 1993-1994 | 1994-1995 |
|---|---|---|---|---|---|
| Total Number of Companies | 320* | 315 | 314 | 314 | 301** |
| Number of Companies making profits | 101 | 223 | 202 | 210 | 212 |
| Revenue after deducting tax (1) | 952 | 2037.54 | 2454.857 | 2730.313 | 3576.894 |
| No. of Loss making Companies | 219 | 92 | 112 | 104 | 88 |
| Total Deficits (2) | 3100 | 1547.865 | 2455.056 | 2214.926 | 1974.05 |
| Net Profits or losses for Public Enterprise Companies (1) - (2) | (2148) | 489.675 | (199) | 515.387 | 1602.844 |

*Ten Agriculture and Trade Companies were liquidated and four were companies that were separated from other companies.

**A) Three companies were sold to the private sector

B) 95% of ten different companies were sold to the workers. They are now governed by Law 159/ 1981 for Corporations, not Law 203/1991 for Business Public Enterprise.

*Source: Public Sector Information Center*

## 7.6 The Egyptian Restructuring Programme

As a complementary procedure to the privatization programme the GOE has announced a comprehensive enterprise-restructuring programme, the Egyptian Restructuring Programme (ERP), to face operational and financial problems of the

Egyptian SOEs (PEO, 1993). Although many of these companies will require restructuring on a case-by-case basis the general approach is discussed below.

### 7.6.1 Target Group

The restructuring programme is mainly aimed at Law 203/1991 companies that have not been privatized or selected for privatization. This mainly includes strategic industries in which the Government retains a minimum of 60% ownership and companies in which the Government is still seeking alternatives to liquidation. Therefore, as a policy principle, privatization candidates will not be subject to comprehensive restructuring. However, if financial restructuring and/or manpower redeployment is necessary, it is preferred that prospective buyers should assume the responsibility for it[1].

The same principle was stressed in the new Guidelines (PEO, 1996) issued in 1996. It stressed that the technical restructuring of the companies nominated for sale would be the responsibility of the new buyers, and that the management has the responsibility and right to carry out needed maintenance, including deferred maintenance, from corporate sources of income. The holding companies could only participate in financial restructuring through negotiating with banks, when applicable.

### 7.6.2 Objectives of the Programme

The objective of restructuring PEs is to improve their efficiency and restore their medium and long-term viability. This will be attained by implementing comprehensive restructuring that makes the PEs more competitive within the industry. Restructured PEs would then provide high returns to the budget and to the economy as a whole.

[1]In some cases buyers may require that restructuring be done prior to the privatization process and in individual cases the Government could agree.

### 7.6.3 Who is Responsible?

The GOE Guidelines identified the HCs and ACs Boards as the main parties responsible for planning and implementing the restructuring strategy. All parties concerned including the Government, the banking sector, other creditors and the HCs as shareholders would share the responsibility of financial restructuring to the uppermost extent.

### 7.6.4 General Principles

The following are the general principles that guide the restructuring process:

- Physical rehabilitation and financial restructuring of public enterprises do not succeed unless they are accompanied by policies requiring competitive performance, and changes in affiliated companies' management, organization, technology, and marketing strategies.
- Restructuring programmes need to deal explicitly with redeployment and reduction of manpower and management development.
- General trade and industrial policy measures may be insufficient to create competitive capabilities. Collaborative arrangements with successful international firms could create pressure for competitive performance and provide needed technology, funding and marketing know-how.
- The degree of vertical integration of companies may be excessive, and this may decrease economic efficiency. In such cases, restructuring options should consider divesting non-core activities.
- Commitment to, and capacity for, major changes by the main participants at the AC, HC and Government levels are a critical element for successful public enterprises restructuring.

### 7.6.5 Restructuring Candidates

HCs are expected to carry out review studies of their portfolio of ACs to select candidates for restructuring. The studies should be based on audited financial statements and visits to the companies. If expert assistance is needed HCs may request the PEO to provide it. The review report should include:

- Identification of major problems.
- Review of manpower structure.
- Analysis of the most recent audited financial statements. (Particular attention should be paid to inventories, accounts receivable and payable, arrears and intangible assets).
- Recommendation to restructure the company, if required.
- Preliminary indications concerning the type of restructuring needed (financial / limited or comprehensive).

#### 7.6.5.1 Selection Criteria

The selection criteria of restructuring candidates should be based on a set of indicators to measure the degree of economic and managerial efficiency and financial viability. Proposed indicators are:

- Negative or low operating income and return on invested capital.
- Large cumulative losses.
- Negative or low net worth.
- Low productivity of labor, over-staffing problems.
- High levels of arrears.
- Negative or low working capital.
- Large debt/equity ratio.
- Low inventory turnover.
- Negative cash flows front operations.

### 7.6.6 Annual Restructuring Programme

Many restructuring measures can and should be taken by ACs. However, there are cases where the assistance of the HC and / or the PEO are necessary. Thus, for this group, it is necessary to establish a list of "priority candidates". Initially, they are the companies with the most acute problems, which are reflected in:

- significant current and cumulative losses;

- a large number of redundant employees; and / or
- substantial unutilized fixed assets.

However, preliminary analysis should show a good chance to restore the viability of an AC through restructuring. Based on the review studies discussions should take place between the PEO and the HC's and between HCs and ACs to agree on a list of restructuring candidates and on priority candidates. Each HC's Board would then prepare its annual restructuring programme. Those programmes would form the basis for the PEO annual restructuring programme. Annual programmes depend on the resources available and the capacity of the HCs and the PEO to organize and monitor the restructuring process.

## 7.6.7 Phasing and Timing

The AC's Board is responsible for ensuring that the study is carried out in an efficient and timely manner. It will have to decide upon the required expertise, the composition and responsibilities of the consulting team and to prepare the Terms Of Reference (TOR) of the study. The HC should review the draft TORs and the proposed composition of the consulting team. The restructuring process includes the following phases:

**Phase 1:** Performing a restructuring study, which covers:

a) An indepth analysis of:

- product mix/market structure and marketing policies;
- technology, facilities, inputs and production costs;
- management and organization;
- manpower;
- legal and regulatory framework;
- financial analysis, and
- the impact of the state of the economy on the enterprise.

b) A restructuring strategy and plan to restore technical, economic and financial viability. The plan should include:

- options for realistic financial restructuring;
- proposals for other aspects of comprehensive restructuring; and

- cost evaluation and financing plan for comprehensive restructuring, and
- financial projections.

**Phase 2**: Evaluation of the restructuring strategy and plan by the AC's Board:

**Phase 3**: Approval by the HC's board and by the AC's General Assembly and review by the PEO for major restructuring. Appropriate strategy concerning the financial restructuring package and the financing of other restructuring needs should be designed. The HC should define its own financial participation. Throughout the review process, consultation should take place with all parties involved as to each preliminary agreement on restructuring options and issues of manpower and financing.

**Phase 4**: Negotiations should take place with all those concerned with the restructuring operation i.e. labour unions, banks, suppliers, and other shareholders. A detailed restructuring programme and timetable should then be drafted and approved by all parties and the General Assembly of the AC.

**Phase 5**: Once approved by the AC's General Assembly, the restructuring programme should be implemented under the responsibility of the AC's Board and monitored by the HC. Periodic progress reports should be sent from the HC to the PEO for major restructuring operations.

The time needed to complete phases 1 to 4 is approximately 6 months for limited restructuring and could be longer for more comprehensive restructuring. The objective is to accomplish the above as quickly as possible. Appropriate "emergency measures" should be taken to avoid further deterioration in the AC's conditions whenever the start of the restructuring programme is delayed.

### 7.6.8 Financial Restructuring

Many of the problems that SOEs are going through in Egypt are initially financial problems. This is why financial restructuring is considered a main component of the programme. The following paragraphs explain the process.

### 7.6.8.1 Financial Discipline

Some of the PEs benefited from loans at low interest rates from the National Investment Bank (NIB) and from Budget subsidies. They borrowed short-term funds to finance investments. The Government has taken important policy measures to harden the "soft budget constraint". Any new loan that requires explicit State guarantee would have to be approved by the Minister of Finance.

The following indicators characterize current operational and financial problems for a number of PEs:

- negative or low operating income and low return on assets;
- negative or low net worth due to large cumulative losses;
- high levels of arrears to public sector banks and other creditors, and
- high debt-equity ratios and low liquidity position.

Financial discipline at the AC level is the main responsibility of the HC. The Government and the banking sector should reinforce the HC efforts.

HCs should follow a number of policy principles:

- HCs must seek to maximize their profits and the value of their portfolios;
- no direct or indirect subsidies should be provided to affiliated companies;
- cross-subsidies through transfer prices, cross equity participation, or otherwise should not be allowed among affiliated companies of the same HC;
- ACs should obtain debt financing in the capital market on market terms;
- investments in new ventures should be made by HCs only as part of the restructuring plans of affiliated companies, and
- *equity financing* is *the normal* way for HCs to finance their ACs. Equity funds will be allocated efficiently by HCs among affiliated companies based on the highest anticipated returns.

However, as a rare exception to the above and for restructuring purposes only, a HC may lend funds or guarantee bank loans to its affiliates. But this ability should be limited to the restructuring period and based on a detailed restructuring plan that shows sustainable viability.

### 7.6.8.2 The Process of Financial Restructuring

Financial restructuring is not undertaken as a rescue measure but only on the basis of a plan that indicates sustainable viability of the AC. The objectives of financial restructuring would be:

- to restore an adequate financial structure and liquidity position; and
- to reduce indebtedness to a level commensurate with the enterprise's capability to service its debt.

The standards to be met to reach these objectives should be:

- adequate debt / equity ratio;
- adequate working capital, and
- adequate debt service coverage ratio[2].

#### 7.6.8.2.1 Financial Restructuring Tools

In designing a restructuring package, a number of tools can be used on a case by case basis:

- ***Debts Rescheduling and/or Write off***

  This is a major part of any financial restructuring through negotiations with creditors. However, a global solution should be discussed between the government and the banking sector concerning rescheduling principles, the share of losses that the bank could bear, and the pace at which debts are to be written off.

In designing debt relief packages achieving and maintaining financial discipline are an important objective. Therefore debt relief should be limited to an amount that is adequate to restore financial viability.

- **Debt-equity Swaps**

In this process creditors are changed into owners by changing their debt into equity. Valuation of the concerned PE is a prerequisite for a swap operation. While

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[2]Defined as profit after tax plus interest and depreciation, divided by interest plus principal payment for the year.

there are legal limitations to the swap process, it should be encouraged for the following reasons:

- it would help restore the equity base of the enterprises;
- it would allow creditor banks to be represented on the boards of the enterprises and advise them during the restructuring process, and
- the sale of the shares following a successful restructuring operation could be used to initiate the privatization process.

❖ **Injection of New Equity Funds**

The holding companies should participate in the financial restructuring package through injection of new equity. Other affiliated companies may buy part of the new stock, subject to conditions detailed above in the financial policy principles for holding companies. This is only permitted for restructuring purposes and not as a general policy.

❖ **Re-evaluation of Assets**

The book value of certain fixed assets (land, buildings and to some extent equipment) could be undervalued. Re-evaluation of these assets may absorb part of the accumulated losses. However, this is not possible under the Egyptian Accounting Standards unless the legal status of the company is changed. This issue needs to be examined to determine the changes that should be introduced to permit asset reevaluation, under special circumstances.

❖ **Collection of Receivables**

This is a matter of high priority to generate cash. The concerned parties should establish a schedule for settlement of arrears.

### 7.6.9 Comprehensive Restructuring

In many cases, financial restructuring alone is not sufficient to restore sustainable viability of PEs. More comprehensive restructuring is necessary. In those cases, restructuring strategies and plans should be developed to restore the technical, economic and financial viability of PEs.

#### 7.6.9.1 Strategy

A restructuring strategy should aim at verifying whether an enterprise continues to be economically viable, or whether it can be made viable. To that end, every product line will be assessed on the basis of its competitiveness (price, quality and service), market share, cost structure and profitability (return on invested capital).

- If competitiveness and profitability of a product line can be restored at relatively low cost within a reasonable time span, then restructuring of that line should be undertaken.
- If competitiveness and profitability of a product line cannot be restored for reasons that include low quality of products, obsolete technology, high costs of production, unutilized production capacity, then production should be terminated, and plant and equipment should be phased out.

However, should the studies identify other products/markets utilizing present facilities, know-how, manpower and management, the return on invested capital required for the new production lines must be adequate. Also, the cost of restructuring must be commensurate with the financial capabilities of the company.

#### 7.6.9.2 Main Areas of Comprehensive Restructuring

Restructuring measures in three main areas usually support strategies for new products and markets:

❖ **Physical Restructuring:**

In most cases, it is advisable to observe the following:

- Cost reduction and productivity measures, energy efficiency, maintenance and quality control. These measures increase economic efficiency.
- Rehabilitation or replacement of obsolete equipment: These two alternatives should be compared on economic grounds before a decision is taken.
- Introduction of new technology: This may entail the change of a complete line of equipment and should be justified on strategic as well as economic grounds.

- Relocation of production facilities. This should be explored to take advantage of tax benefits, access to new markets, supporting infrastructure, manufacturing synergies or sale of valuable land.
- Identification and sale of idle and uneconomic assets: Many PEs have unnecessary or unutilized assets which could be sold to generate cash.

❖ **Management and Organization**

Improving management and organization of PEs is a key element for the success of any restructuring operation. Considerable attention is to be paid to evaluating management qualifications and leadership. Organizational issues, including decentralization and creation of cost and profit centres, should also be carefully addressed.

❖ **Manpower**

Restructuring options should be developed for each aspect of manpower and should cover manpower skills, experience, qualifications and compensation. Restructuring plans should deal with the following critical issues:

*Redundancy*

The cost of over-employment can be very high in terms of direct costs, poor morale, low productivity and poor product quality. Therefore, over-employment issues could be addressed through a variety of social oriented programs such as:

- early retirement schemes;
- redeployment among other affiliates, when economically feasible;
- severance payments to retain qualified staff when voluntary departure schemes are in effect, higher salaries and incentives need to be offered. Savings resulting from manpower reduction will help meet this goal;
- retraining programs should focus on areas of immediate need or where demand is expected, and
- employee buy-outs to facilitate buy-outs of small workshops, garages and transportation units should be designed (the Social Fund for Development, the Egyptian Industrial Development Bank and the Credit Guarantee Corporation could provide assistance in management techniques and in financing the acquisitions).

*Compensation*

When designing restructuring programs, it is necessary to improve current compensation and incentive policies in order to improve the performance of workers and managers, and reach sustainable economic viability. Law 203 made this possible as it repealed the provisions on uniform wages.

*Training*

There is a need to prepare a comprehensive program for manpower development based on local institution building to:

- compensate for deficiencies diagnosed through manpower analysis, and
- accompany restructuring measures in marketing, production, technology, management systems and organization.

Training programs have been designed by the PEO for managers to upgrade a range of functional skills. The restructuring plans should consider using PEO training programs and/or identify specific actions to train managers where needed. Specific on- the-job training programmes should be defined for middle management and workers.

### 7.6.10 The Restructuring Fund

The total cost of financial restructuring, manpower redeployment, and severance payments, could pose an obstacle to efficient restructuring. It was, therefore, recommended in the first set of guidelines issued in 1993 to establish a *Public Enterprise Restructuring Fund to* be generated through donor assistance and part of the privatization proceeds. The Fund would mainly finance redeployment costs and severance payments, and liabilities to banks and creditors. Fund resources could be utilized upon approval of a restructuring program based on detailed plans. The Fund could also provide the same kind of assistance in liquidation cases when proceeds from the liquidation of assets cannot cover the redeployment and severance costs.

The 1996 guidelines also clarified that proceeds of past divestitures and assets sales could be used in financial and technical restructuring, but only after the Minister of Finance's approval. Withdrawals from HCs could also be used in some cases but would require the Minister's approval and the Cabinet Committee approval on privatization.

## 7.6.11 Eligibility Criteria for Restructuring Assistance

The GOE set several rules for companies to be eligible for technical or financial assistance:

### 7.6.11.1 Eligibility for Technical Assistance

To be eligible for technical assistance from the PEO, an AC should be on the "priority candidates" list. A formal decision to enter the restructuring process must have been taken by the AC's Board and General Assembly. Applications submitted to the PEO for technical assistance should contain a brief analysis of the AC's operating and financial position, the main problems facing the company, its need for and expected benefits of restructuring and terms of reference of the study. TORs should specify the scope of work and the exact services to be provided by consultants, the expected concrete output and a time-bound work plan.

Upon the approval of applications by the PEO Director, assistance with the selection and contracting of consultants would be provided. A letter of understanding between the PEO and the relevant HC/AC specifies the services to be provided by the consultants and obligations of the HC and/or the AC, including provisions for possible cost recovery.

### 7.6.11.2 Eligibility for Financial Assistance

To be eligible for financial assistance from the HCs and/or the Government, directly or through the Restructuring Fund, an AC must fulfill the following conditions:

- The restructuring study must show that sustainable economic and financial viability will be attained if the restructuring plan is implemented.

- The restructuring strategy and plan have been reviewed by the HC's Board and the PEO for major restructuring and approved by the AC's Board and General Assembly.

### 7.6.12 Liquidation

When a restructuring study concludes that sustainable economic viability of an AC cannot be restored at a reasonable cost, this AC should be considered for liquidation. Recommendations to liquidate should be made by the HC's Board and a decision whether to liquidate should be made by the AC's General Assembly.

- Should the General Assembly decide not to liquidate, it must give reasons and specify options to be pursued.
- Should the General Assembly decide to liquidate, provisions of Law 159 (articles 137-154) and Law 203 (articles 38-39) are to be followed. The General Assembly should:
  - issue an order of dissolution;
  - appoint one (or more) liquidator(s) and determine their remuneration;
  - specify the period within which the liquidation process is to be finalized, and
  - determine the method of sale of the AC's assets.

The liquidation process should be conducted diligently, at reasonable cost and should aim at protecting the legitimate interests of all parties concerned: employees, creditors and shareholders.

In order to perform liquidation efficient and in compliance with the law, the following aspects must be addressed:

- liquidator's Qualifications;
- bankruptcy Issue; and
- manpower Issue.

❖ **Liquidator's Qualifications**

It is strongly recommended that a professional liquidator supervise the liquidation process. The PEO should draft TORs and define qualifications of liquidators; PEO is to prepare a roster of qualified liquidators for use by HC's and AC's. Once the liquidator is appointed by the General Assembly, he should proceed according to the Law. In selling the AC's assets, he should select the most appropriate methods and may request the advice of the HC, and if necessary, the PEO specialists.

❖ **Bankruptcy Issue**

Under current law, a creditor can file a bankruptcy case during the liquidation process. This could delay the whole procedure and increase the cost of liquidation. To avoid such problems, a "liquidation committee", including representatives of creditors and shareholders, could be appointed by the General Assembly. The committee is to supervise the liquidator and the liquidation process to preserve the interest of all concerned parties.

❖ **Manpower Issue**

Under labor Law 137, liquidation of an AC will result in the termination of all existing employment contracts (Art. 9/2). However, obligations towards employees prior to liquidation must be honored (Art. 9/1). The liquidator should send notices of termination of employment contracts. This course of action is not, usually, taken for socio-political reasons. Therefore, it is necessary to prepare, as early as possible in the liquidation process, a plan for employees' redeployment/separation. It is also recommended that labor unions be consulted about the process.

Redeployment of employees among HCs' affiliates should not be done unless it is justified on manpower, economic, and financial grounds.

### 7.6.13 Comments on the Egyptian Restructuring Programme

Although the announced Egyptian Restructuring Programme (ERP) deals with many aspects of restructuring, it lacks the comprehensive approach of an integrated plan. The programme is rather general, representing guidelines in dealing with the restructuring problem. It offers possible options to deal with problems but falls short of providing an action plan. It also lacks details concerning how to tackle problems like past debts, accumulated stock and manpower issues. It is more like an academic step-by-step document rather than a task-oriented, target-based programme.

The ERP also does not sufficiently address many of the common problems causing low performance in SOEs. Government interference, non-commercial objectives, multiplicity of control bodies, inadequate cash management, determining criteria for choice of management are examples of issues that are not sufficiently addressed by ERP.

Reasons behind this general approach in the ERP could be that the GOE does not want to take a more active role in restructuring. The programme states that, as a general principle, it prefers that the purchaser would perform the restructuring. However, this would undoubtedly lower the sale price and in some cases make it impossible. The costs of restructuring should be compared with the increase in the sale price.

The restructuring plan also lacks a monitoring system that should include the companies in need of restructuring and how far the programme has been implemented and where it stands in specific companies.

Another aspect in the programme needing more attention is giving priority of restructuring to companies 'with the most acute problems'. In many cases these companies should be liquidated rather than restructured. The substantial amounts of money needed to restructure a company with huge accumulated losses might be more wisely spent on a few other companies that are easier to restructure.

Table 7.2 compares the Egyptian Restructuring Programme to the widely accepted elements of successful enterprise reform programmes mentioned in section 7.4.

**Table 7.2: A Comparison of ERP to the Most Common Elements in Successful Enterprise Reform Programmes**

| Most Common Elements | The Egyptian Case |
|---|---|
| • Introducing into SOE organization attributes of the modern corporation for the purpose of achieving commercial objectives. | Introducing attributes of modern corporations for the purpose of achieving commercial objectives is not very evident as an important aim of the ERP. Rather, general procedures of physical and financial restructuring are mentioned as guidelines. |
| • Introducing competition from the private sector, international sources and SOEs in product and labour markets. . | The whole privatization programme is directed to introducing more competition at the national level. Isolation of economies is no longer possible and exposing SOEs to international competition became inevitable due to the modern market regulations and conditions (e.g. GATT). |

| | |
|---|---|
| • Cutting direct and indirect financial subsidies from government to SOEs. | There is no mention of direct or indirect Government subsidies to SOEs in the ERP. The programme only mentions HCs' subsidies to affiliated companies, forbidding them except under very special circumstances. Although the Government in several different incidents (Al-Ahram, 24th January, 1996) announced cuts in direct subsidies to SOEs, most SOEs still enjoy large amounts of indirect subsidies (e.g. low-cost raw materials and less-than-cost electricity and water charges). Also, many products are still directly subsidized (e.g. food products and medicine). Up till 21st November 1998 the Minister of Public Enterprises was announcing that direct subsidies on essential products and indirect subsidies on different supplies to SOEs would continue for years to come (AlHawary et al, 21st November 1998). |
| • Reforming the financial sector, including upgrading prudential *regulations and banking supervision* systems so that the financial sector might be able to provide the necessary external incentives and discipline. | The ongoing Egyptian Economic Reform Programme (EERP) has to a great extent addressed this problem (Chapter Two). |
| • Separating the role of owners (i.e. Government) from the day-to-day management of the SOEs while also minimizing the number of bureaucratic layers between the company and the Government, e.g. in a large state, allowing provincial bodies to represent their owner interests without interference from the Government. | Separating the role of the Government from day-to-day management of the SOEs and giving managers more autonomy has been announced as one of the major objectives of privatization. Yet, practically there is still much scope for interference (e.g. labour related issues, top management recruitment, pricing of products and determination of product mix and priorities of renovations). Also, although the number of layers was reduced in many aspects, there are still many layers in decisions like valuation and selling. |
| • Unbundling non-core businesses from the SOEs. | This is not directly mentioned in the ERP. However, a few SOEs were unbundled and separate units were sold as individual assets or as ongoing projects e.g. Sheraton Hotel. |
| • Transferring many of the social functions from the enterprise to | Many of the social functions of the enterprise were not completely |

| | |
|---|---|
| municipal or central Government Authorities. | transferred to central Government. This is especially important in labour-related issues. Although new employment in SOEs has been stopped, all official statements stress that employment will not be affected by privatization, whatever the real for workforce requirements of a company to be privatized. This means that existing jobs will remain as they are, mainly due to social reasons. Pricing of products is also an area in which social objectives are usually taken into consideration. |
| • Introduction of necessary social safety net, including pension system and unemployment services. | Several schemes are mentioned in the ERP. Some of them have actually been implemented and others are still being studied (Chapter Eight). |
| • Revision of state functions through the creation of an ownership neutral policy regulatory framework for commercial enterprises, removing distortions (price controls) and correcting disincentives (tax policy and administration) for greater equity and efficiency. | The ongoing Egyptian Economic Reform Programme has tackled several of these problems (Chapter Two). |
| At the enterprise level<br>• Setting well – defined goals for SOEs, which can be transformed into measurable and manageable targets.<br>• Giving managers the freedom (sufficient autonomy) to act and hence to be answerable for results achieved.<br>• Selecting efficient people to run the commercial venture and paying them well.<br>• Managers are held responsible for results achieved including rewards and sanctions. | Restructuring measures at the enterprise level in ERP are mostly focused on financial aspects. Restructuring measures concerning management are limited to evaluating management qualifications and leadership and some organizational issues including decentralization and creation of cost & profit centers. Restructuring compensation structures are mentioned as part of manpower restructuring. Well-defined objectives, autonomy and accountability are not sufficiently addressed in ERP. |

Comparing the most common elements in successful enterprise reform programmes (Shirley, 1989) with the Egyptian Restructuring Programme (ERP) shows that:

- The EERP has tackled many necessary reform aspects at the national level.
- A number of elements have not been sufficiently addressed by the ERP, namely:

- Eliminating direct and indirect subsidies to SOEs.
- Separating the role of the Government from day-to-day management of SOEs.
- Reduction of the number of layers in decision making especially in valuation and selling related decisions.
- Many of the social functions of the enterprise have not been completely transferred to central Government Authorities especially in pricing products and labour-related issues.
- The necessary social net for unemployment is not completely developed.
- At the enterprise level well-defined objectives, autonomy and accountability among managers are not sufficiently addressed.

In order to assess the practical effectiveness of the Egyptian Restructuring Programme the researcher found it beneficial to demonstrate the performance of loss making and low performing enterprises after six years of implementing the restructuring programme.

## 7.7 Was the ERP Effective in Dealing with Low Performance in SOEs

This section will review a few indicators that reflect results of implementing the restructuring programme in Egypt for six years. It mainly depends on the report prepared by the Central Agency for Accounting and Auditing (CAAA) presented to the People's Assembly on $15^{th}$ April, 1998, concerning different performance indicators of SOEs. It is worth mentioning here that the CAAA is the main Government monitoring authority for SOEs.

The section includes aggregations of financial results of low performing and loss-making SOEs in the financial years 1994/95 and 1995/96[3]. Afterwards, a number of the most common problems that still exist in SOEs are presented, namely, unutilized capacities, accumulated inventory and frozen debt accounts. Each section contains the most common reasons for the problem as cited by CAAA in an attempt to investigate whether these reasons have been sufficiently addressed in the ERP. The Minister of the Public Enterprises comments on the different problems are then summarized to present the GOE point of view.

[3]The official Government financial year starts on 1st of July and ends on $30^{th}$ June.

### 7.7.1 Aggregate Financial Results of Loss Making and Low Performing SOEs for the years 1994/95 and 1995/96

The report by the CAAA divided the low performing SOEs into five categories on the basis of their profit and loss making:

- Companies that were profitable in 1994/95 and became loss making in 1995/96
- Companies in which losses increased in 1995/96 as compared to 1994/95
- Companies in which losses decreased in 1995/96 as compared to 1994/95
- Companies that were profitable in 1995/96 but still have accumulated losses from past years
- Companies that could still be considered low performing although they succeeded in making profits in 1995/96 and that do not have accumulated losses.

**Table 7.3: Aggregate Financial Results of Loss-making SOEs for the Years 1994/95 and 1995/96**

| SOE Category | Number | | Financial Results (L.E. million) | |
|---|---|---|---|---|
| | 95/96 | 94/95 | 95/96 | 94/95 |
| 1. SOEs that were profitable in 94/95 and that became loss-making in 95/96 | 28 {26}* | 18 | (417.9) | |
| 2. SOEs for which losses increased in 95/96. The accumulated losses in these companies nearly covered and in many cases exceeded their capital. The CAAA recommended liquidation of these companies to their General Assemblies but was refused. | 62 {61}* | 43 | (3235.9) | (1818) |
| 3. SOEs for which losses decreased in 95/96. The CAAA recommends special programmes for these companies. | 23 {18}* | 23 | (526.9) | (718.3) |
| **Sub-total** | **113** | **84** | | |
| 4. Companies that still have accumulated losses in spite of making profits during 95/96. Some of the accumulated losses exceed or nearly equal the company capital. | 32 {28}* | 32 | 127.1 | (1306)** |
| 5. Low performing companies that have earned profits and that do not have accumulated losses. | 19 {14}* | 19 | 37.5 | |
| **Total of loss-making SOEs** | **164** | **135** | | |

* PEs affiliated to Law 203/1991, the remaining companies are SOEs that do not follow the Law 203/1991.

** Accumulated losses from previous years

*Source: Central Agency for Accounting and Auditing (CAAA), presented to People's Assembly on 15th April, 1998.*

❖ **Comments**

From the previous table one could notice:

- There are a number of companies that were profit-making and changed to loss-making.
- Losses have increased in many companies in spite of reform efforts.
- There are a number of companies in which accumulated losses nearly equal or exceed capital and in which liquidation was recommended and denied.

- Losses have started to decrease or started to change into profits in a few companies.

This report is of special importance since it shows the continuation of SOE losses in many companies although the privatization and restructuring programmes have been running for six years at the date of the report. Knowing the importance of stopping these losses which represent a drain on national wealth, it is not understandable why these losses have continued and why no quicker action has been taken. Although the privatization policy offers several options including restructuring, selling and liquidating loss-making SOEs, in many cases very little action has taken place. This again leads to question the extent of Government commitment to the privatization policy and the different options it offers.

Reducing and stopping SOEs' losses and increasing efficiency of low performing SOEs are unquestionably important. In SOEs that are to be offered for sale, stopping losses would increase chances of selling SOEs at better prices and in SOEs that are to stay in Government hands stopping these losses would free the State Budget from an increasing burden. If liquidation is the most appropriate option, then it is important that this option should be pursued without delay. However many factors could slow the process. These factors could be political (related to Government commitment to privatization), economic (related to obstacles to cost reduction and restructuring) or social (related to labour issues and the possible lay-off of workers).

The classification of loss-making companies used in the CAAA report could also be very useful in choosing the different candidates for restructuring. The basis of choosing priority candidates could be companies in which loss making is a new phenomenon or in which losses have decreased or changed into profits. On the other hand, GOE could prefer starting with companies with bigger losses to remove a greater burden from the State Budget. At the same time, there is no point in keeping or restructuring companies in which losses are nearly equal or exceeding their capital especially if losses are continuing.

### ❖ The Most Common Reasons for Continued Low Performance as cited by CAAA

The CAAA report also identified the major reasons for low performance of SOEs (CAAA report, April 1998). The following lines include a summary of those reasons followed by a brief account of CAAA recommendations and finally the researcher's comments:

**A. Reasons related to the production operation itself**

1. Some of the companies own assets that exceed their needs.
2. Non-optimal utilization of the available capacity.
3. Annual increases in production costs as a result of Government decisions.
4. Increase of labour compared to normal economic standards.
5. Starting work in new areas the companies are not prepared for.
6. As a result of all these factors those companies became uncompetitive whether on the national or international level.

**B. Reasons related to financing assets**

1. Unbalanced disturbed financial structures.
2. Freezing large amounts of money in investments in joint projects that have weak financial positions.
3. Delay in implementing projects.
4. Contracting out some tasks to inefficient contractors.

**C. Reasons related to marketing of products**

1. Low marketing and management skills.
2. Many SOE customers have stopped paying their bills to those companies.

**D. Reasons related to surrounding environment**

1. Insufficient information at the national level.
2. Economic factors leading to increase in on credit trade.
3. Increase in exchange rates.
4. Tax holidays and other financial privileges only given to private sector competitors.

❖ **CAAA Recommendations**

**A. Concerning Finance**

1. Supporting self-financing by increasing capital either by elimination of unneeded assets or activating collecting customer dues.

2. Achieving equilibrium in financial structures by changing part or all of the debts into equity, changing short-term debts into long-term debts and rescheduling some of these debts.

**B. Concerning Management**

1. Strategic recommendations: Determining standards for management efficiency and applying them as basis of recruitment, continuation in jobs and promotion, rationalizing utilization of raw materials and more efficient training of personnel.
2. Operational proposals: More attention should be paid to marketing with special reference to pricing studies.

❖ **Comments**

The CAAA report summarizes the most common problems in low performing SOEs. These problems are not sufficiently addressed in the ERP. At the same time there is no evident link between the CAAA, the main GOE monitoring body for SOEs, and the structure in charge of privatization or restructuring, which makes studies and recommendations of the CAAA in vain. Time and costs would be more rationally used if these studies and recommendations were taken into consideration in designing and implementing privatization and restructuring programmes.

## 7.7.2 The Most Common Problem Areas in SOEs

To identify the major problem areas in SOEs a brief account of a few indicative figures is included in this section (CAAA, April, 1998). The aim of this section is to investigate whether these problem areas are sufficiently addressed in the ERP.

### 7.7.2.1 Unutilized Production Capacity

One of the major objectives of the privatization and restructuring programmes is efficient utilization of physical and human resources of the different companies.

The following table summarizes the unutilized capacities in the different SOEs on 30th June, 1996.

**Table 7.4 Unutilized Capacity in SOEs on 30th June 1996**

| Category | Unutilized Capital Capacity | | | Total Fixed Assets added to Projects Under Construction | Rate of Unutilized Capacity |
|---|---|---|---|---|---|
| | Unutilized Capacity | Production capacity under construction | Total | | |
| | 1 | 2 | 3 | 4 | 3 / 4 |
| Law 203/1991 Companies | 2616 | 3802 | 6418 | 42979 | 14.9% |
| Other SOEs | 620 | 984 | 1604 | 16353 | 9.8% |
| Total | 3236 | 4786 | 8022 | 59332 | 13.54% |
| Comparative Importance | 40.3% | 59.7% | 100 % | | |

*Source: Central Agency for Accounting and Auditing (CAAA), presented to People's Assembly on 15th April, 1998.*

As evident from the table the unutilized capacity in SOEs is of two kinds: productive capacity which is not utilized (40.3%) and capacity under construction or being prepared for production (59.7%). Although reasons for unutilized reaching 13.54% of total assets vary from one company to the other, the most common reasons identified by the CAAA, have been cited to assess whether they are sufficiently addressed in the ERP.

**The most common reasons for unutilized capacity**

1. Inaccuracy of feasibility studies leading to too much or unneeded capacity being installed.
2. Unutilized land and buildings due to termination of related projects, insufficiency of preparations or existence of judicial disputes related to the assets.
3. Importing some of the machinery using grants or foreign borrowing without really needing the machinery or finding operation costs too high.
4. Delay in licenses and official documents permitting operations.
5. Existence of technical deficiencies in some machinery or production lines.
6. Low and slow maintenance and rarity of spare parts.
7. Liquidity crisis causing delays in production.

8. Unavailability of trained skilled labour.
9. Low quality of production affecting competitiveness of products whether on the national or international level.
10. Low marketing skills.
11. Availability of foreign substitute for products at lower prices.

**The most common reasons for the delay of projects under construction**

1. Inaccurate feasibility studies before implementation of the projects.
2. Insufficiency of funds needed for the projects.
3. No need for some of these projects.
4. The late arrival of some of the parts or machines.
5. The dependence of some of the projects on other unfinished projects.
6. Problems concerning disputes or delays in implementation by contractors.
7. Technical problems or mistakes delaying operation.

**CAAA Recommendations**

1. Studying technical and economic feasibility more effectively before implementation.
2. Not starting addition of new capacity before full utilization of existing capacity.
3. More strict periodic maintenance.
4. Studying development of obsolete machines to allow their utilization.

❖ **Comments**

Looking at the unutilized capacity problem and examining the reasons behind it and comparing them to the ERP show that most of the reasons for unutilized capacity are not sufficiently addressed in the ERP. The only mention of unutilized capacity is in the possibility of sale of some of the unutilized units to raise funds. Solving problems causing this unutilized capacity or trying to use it more effectively are not mentioned.

### 7.7.2.2 Accumulated Inventory in SOEs

Another common problem in SOEs, according to the CAAA report is accumulated inventory. Although maintaining inventories is essential to meet production and marketing requirements without disruptions, excessive accumulated inventory generally reflects ineffective planning, poor management and ineffective marketing and increases costs. Managing inventory to maintain optimum stock is beyond the scope of this study, but it was found beneficial to present some aggregate figures to demonstrate one of the most common problems in SOEs examining whether it is sufficiently covered in the ERP.

Accumulated stocks in SOEs fall into one of three main categories: unfinished products that need to be turned into sellable finished products; production requirements, and finished goods (which may be (a) waiting to be sold or supplied or (b) could not be sold because of over production or unsuitability of product). Table 7.5 summarizes the slow moving stocks development.

**Table 7.5: The Relative Importance and the Rate of Development of Accumulated Goods in Stock**

*L.E. millions*

| Statement | 30th June 1995 | | 30th June 1996 | | Rate of Development |
|---|---|---|---|---|---|
| A. Inventory from industrial operations: | Value | % | Value | % | % |
| ▪ Production Requirements | 365.4 | 35.5 | 468.1 | 33.1 | 28.1 |
| ▪ Unfinished Production | 113.8 | 11.1 | 75.8 | 5.4 | - 33.4 |
| ▪ Finished Goods | 355.9 | 34.6 | 686.7 | 48.6 | 92.9 |
| **Total** | **835.1** | **81.2** | **1230.6** | **87.1** | **47.5** |
| B. Inventory bought to be sold | 192.5 | 18.8 | 182.5 | 12.9 | - 5.2 |
| **Total Accumulated Inventory** | **1027.6** | **100** | **1413.1** | **100** | **37.5** |

*Source: Central Agency for Accounting and Auditing (CAAA), presented to People's Assembly on 15th April, 1998.*

As evident from table 7.5 total accumulated inventory has increased by 37.5% from June 1995 to June 1996. Also total finished products' inventory (L.E 686.7 million) representing 48.6% of the total inventory in June 1996 has nearly doubled compared to the previous year reflecting an increasing problem in marketing. These increasing figures show that whatever the problem is, it has not been solved.

According to an accompanying report the total amount of inventory in SOEs reached L.E 25.7 billion representing 32.6% of the total capital invested in these companies. This is definitely a very high percentage that should be investigated. More efficient inventory planning is needed to rationalize resource utilization.

Furthermore, the report identified the companies where the problem is more serious (CAAA report, April 1998). According to the June 1996 figures, 33.4% of the accumulated finished products in public enterprises are concentrated in 11 companies out of a total of 295 companies working under Law 203/1991 (PEs). Five of these companies are in the spinning and weaving industry. The report also identified the companies in which unfinished products, production requirements and goods bought for sale inventory were more concentrated. This information is not sufficiently utilized in the ERP. Although reasons of accumulation of inventory vary from one company to the other, the CAAA report identified a few of the most common reasons. These reasons are summarized below.

❖ **The Most Common Reasons for Accumulated Inventory**

1. Inefficient planning and insufficient marketing studies prior to production resulting in products not matching customer requirements.
2. Inefficient inventory planning, management and control.
3. Obsolete machinery or production techniques resulting in poor quality or high cost products.
4. Decisions to terminate production of some goods while production requirements are still available.
5. Change in some product prices leading to fall in demand.
6. Delay of receipt of some of the seasonal products or product requirements.

❖ **Comments**

By studying ERP, it is evident that the issue of accumulated inventory is not addressed at all in the announced programme in spite of its importance. However, concentration of the problem in a number of companies and the identified reasons for the phenomenon could facilitate addressing the problem more effectively. In general, one would expect more utilization of the information presented by the CAAA in planning and implementing the ERP.

#### 7.7.2.3 Frozen Debit Accounts

Another problem most SOEs still have is the increasing amount of arrears that SOEs fail to collect. Although the ERP gives a priority to collecting receivables, at the end of June 1996 the total amount of debit accounts in SOEs reached L.E 41.7 billion which was an increase from the June 1995 figure of L.E 37.9 billion. The debit figures represented 52.1% of the total invested capital (L.E 80.1 billion) in 1995 / 96 and 49.7% of the total invested capital (L.E 76.3 billion) in the year 1994 / 95. Accounts that did not move for more than one year reached L.E 13.2 billion, on 30th June 1996, representing 31.7% of the total debit accounts on that date. At the same time, the allowance for possible bad debts decreased from 24.8% in June 1995 to 14.4% of the total frozen debts in June 1996, with no equivalent decrease in debts. These figures reflect inefficient financial management that needs more effective measures on behalf of the ERP. Neglecting this problem leads to liquidity crises faced in many cases by undue borrowing from the banking system[4] and finally causing increasing losses of SOEs.

It is also important here to mention that according to the June 1996 figures, 80.4% of the debit accounts that have not moved for more than one year were concentrated in 4 groups of Public Enterprise companies,[5] and that 51% of those accounts in other SOEs were concentrated in one company[6]. This fact could facilitate restructuring efforts related to the problem of collecting receivables.

Frozen debit accounts in SOEs could be distinctively divided into three categories. Reasons for their increase vary in each category. Due to the importance of these reasons to financial restructuring of SOEs it was found useful to mention the most common reasons causing this problem to investigate whether they are sufficiently addressed in ERP.

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[4]The total credit accounts of SOEs reached LE 26.9 billion in June 1995 and LE 23.1 billion in June 1995.

[5] Frozen debit accounts were L.E 4117.7, 3075.3, 1191.2 and 1156 million in the companies affiliated to the International Cotton and Trade, Electricity Construction and Distribution, the Spinning, Weaving and Clothes and the National Company for Construction and Building Holding Companies, consecutively.

❖ **The Most Common Reasons of Non-settlement of Receivables in SOEs**

Reasons for non-settlement of Government debts to SOEs (representing 55.8% of total debts):

1. Performing tasks and projects for which there was no provision in the budget.
2. Insufficient budgets for projects.
3. Contracting out projects to companies without studying or determining prices, which made companies sometimes over-value their services. The inevitable result was reluctance to pay on part of the Government in many cases and unsettled disputes in more cases.
4. Previous affiliation of some of the companies to ministries (before Law 203/1991) and non-settlement of those ministries' debts to the companies.
5. Payment of higher than market price by cotton export companies to producers according to governmental decrees to encourage production by the latter without a clear agreement on reimbursement of the subsidies to the export companies by the Government.

Reasons for non-settlement of debts amongst SOEs (representing 30.4%):

1. Weak financial structures of many SOEs causing low liquidity and unavailability of cash needed to settle these debts.
2. Some of the SOEs have to sell all their production to other SOE companies inconsiderate of whether they could pay.
3. Inefficient management of collectible receivables.

Reasons for non-settlement of private sector debts to SOEs (representing 13.8%):

1. Insufficient studies of customers' financial positions before allowing them credit.
2. Inefficient magement of collectible receivables and reluctance to take juridical measures against customers.

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[6]Frozen debit accounts reached L.E 676.3 million in the Arab Contractors Company.

3. Recession and other economic factors affecting private sector companies and causing low sales and, in many cases, dependence of these companies on credit sales.
4. Impossibility of collection due to reasons beyond SOE capabilities e.g. customers in Iraq who stopped paying their dues after the war.
5. Inefficient control in previous periods.

❖ **Comments**

Although the ERP does mention collecting receivables as a priority of ERP, as an immediate source of cash, it does not show how this task could be handled. It mentions that a schedule should be initiated to collect those arrears but does not mention who is responsible, when it should be finished or who should be held accountable if it is not done. Also reasons behind this phenomenon are not sufficiently addressed in ERP. Surprisingly, there is no mention of developing financial capabilities of the staff in charge of collecting those receivables.

### 7.7.3 Minister of Public Enterprises Comments on the Continuation of the Problems Facing SOEs

In response to the CAAA report and different questions concerning effectiveness of restructuring, that were raised by fellow members of the People's Assembly the Minister of the Public Enterprises (MPE) representing the GOE addressed the People's Assembly (People's Assembly minutes, 21st April, 1998). The address is included as an appendix (Appendix E) and parts of it are either summarized or quoted in this section (quotes are in bold italics) to present the GOE point of view on the different problem areas facing SOEs and the extent of effectiveness of the restructuring measures:

- The information included in the CAAA reports reflects the past rather than the present. It is based on "***records and thorough investigation***" but they reflect "***history***".
- MPE stated that when he was assigned the responsibility of reform of Public Enterprises the number of low performing and loss making companies was 126. According to his speech the 1998 documents assert that this number went down

to 86 companies. "*We started preparations for the march of reform in 1994/95. Execution started in 1996/1997. Four years of constant work resulted in reforming 40 companies. It is expected that by the end of 1998 the number of low performing and loss making companies will be 10 out of a total of 126 companies,*" were his exact words.

- "*When we took responsibility some companies were achieving profits and others were sustaining annual losses. According to the 1992 records (the year preceding start of reform) total profits of successful companies, after deducting the losses of the loss making companies, amounted to L.E42 million. This figure rose to L.E 1824 million on 30/6/97 which is 45 times the 1992 figure.*"
- He also stated that he expects the "***future***" to be better than the "***past***" and that by the following year, the only companies that would be left for reform would be "*the companies that have been stumbling for more than twenty years and are considered chronic cases. However, these companies shall not be left on their own, they will be supported by us.*"
- Reform needs financial and human resources "*to renew exhausted power, settle longstanding debts, fund early pension schemes and correct the employment structure.*"
- World Bank figures indicate that reform in other countries followed one of two policies. One involved a wide range of liquidations that reached from 45% to 60% of SOEs in those countries and the other involved early selling of SOEs for any price. Both policies were rejected by the Egyptian system that preferred restructuring loss-making SOEs. "***Liquidation is not acceptable to us, because it means reduction of the country's wealth and we cannot accept such reduction***" were the Minister's words. "***Also we did not follow the easiest approach, recommended by many international institutions, which is selling by auction even if the prices are too low.***" "***We heard of companies that would be offered for one Egyptian pound like those sold for one mark or one dollar. This will never happen here.***"
- The Minister cited several examples of successful restructuring of SOEs "***At the start of my taking responsibility, a loss-making company, namely, Beni Souif Cement Company was advertised for sale. The only offer we received***

*was that the buyer bear the debts and buy the company for one pound. Our insistence on reform resulted in endorsing the ultimate evaluated figure at which we would offer the shares of this company as L.E 660 million... Another example is Bisco Misr Company for making biscuits and cakes. We were asked why does the Government involve itself in making such products? Why don't we sell the company especially that it is burdened with debts? The offer made by an investor was a price of ten pounds while bearing all the debts. We settled most of the debts, which gave the company a push and resulted in an increase in profitability. We shall offer the company in two weeks for L.E 160 million."* The third example is "*a sand brick company which needed very high costs for fuel and its reform was almost impossible. We took care of this company and recruited efficient personnel for its service. We estimated its price after restructuring at L.E 180 million. The offer will start after eight weeks from today...The same applies to El-Naser Phosphate Company. Our interest in mining was criticized. The company has been suffering losses for 14 consecutive years. Through proper care and provision of resources the company's status was completely reversed. The company was valued at L.E 200 million."* The last example was Mokhtar Ibrahim Contracting Company. "*It was claimed that contracting work is not our business. Our business is reform. It was said that the losses of the company cannot be overcome. The whole losses, however, have been faced and the company's shares will be offered for sale for L.E 680 million."*

- About the importance of restructuring SOEs the Minister made the following comments. *"Reform is a responsibility and commitment. Difficulties should not be an excuse for stopping reform...Restructuring increases the value of companies to society's gain. The reform movement aims at increasing the added value, which means an enlargement in the size of the amount of which taxes are to be paid. Reform will continue until the value of companies has increased substantially. This leads to renewal of capacities and increase in wages, subsequently, can be funded. Wage increased at the annual rate of 12.5% in the last five years."*

- Regarding funds and whether the State paid for restructuring ***" The State has not paid one pound out of its budget to cover any losses. The losses were covered by the successful companies. "***
- The Minister also certified that State burdens have to be accepted whether they aim at social or economic goals. ***"This should be accepted in a developing country which cannot give up its social commitments. We welcome such a burden and promise to exert further efforts to cover it. "***
- About failure to bring up efficient cadres to perform reform, the Minister admitted that this needs discovery of candidates at an early stage and their training and preparation at well developed institutions, which are still not available. ***"We don't have latent faculties. Neither do we have institutions capable of developing that experience nor have we a free market that would produce such people or develop such institutions." "We have to bear with problems in the period of transition because knowledge comes through experience. We can tolerate errors but not corruption. "***
- Concerning how the officials in charge of restructuring are chosen, the Minister stated that ***"No highly ranked official interferes with selection of cadres to perform restructuring. Recruitment takes place after careful reviewing of specialized experienced people and detailed data are presented to all control bodies with particular stress on the moral history of the candidates. The matter was then referred to the General Assemblies for endorsement. I did not interfere, nor did I allow anyone to interfere. "***
- The Minister also asserted that problems of previously restructured loss making companies will not recur. ***"Timely decision making, discipline and follow up are the main guaranteeing factors for this. In restructured companies the computer gives out monthly reports on the results achieved. In the past, results were available after 14 months. Figures about stock and debit accounts which are vital to performance are available everyday. Councils dedicate their time to check monthly profits and losses. Every month I hold a meeting with my colleagues, Chairmen of HCs, to review the status of every company in detail. Every month we dedicate seven hours at least to every stumbling company. We do not accept liquidation. We shall work hard with stumbling companies to get them out of their crisis. "***

- As for accumulated finished goods inventory *"The figure of finished commodity stock on 13/4/1998 was L.E. 6.2 billion for one year. The sales for the same year were L.E. 50 billion. Commodity stock of L.E 6.2 billion is equal to one and a half months of sales. International stock levels range from one to 14 months of sales. This performance does not come out of the void. It is a result of recording, follow up and control...To be honest there are companies in which this average figure is exceeded especially in the spinning and weaving sector. Accumulated stocks in these companies reached three and four months. But this is a result of old decisions that took place in the past ordering these companies to produce goods for sale in foreign markets which declined to accept them. The commodities were produced regardless of whether they were sellable."*
- As for stock of raw materials *"The raw material stock was LE 6.1 billion at 31/3/1998 for production of LE 42 billion. Two thirds of these raw materials are imported from abroad. It is true that the World reached a stage where it can work on one or two or seven days' stock. In developed countries they can ensure the requirements in a short time. Here the time for preparing orders, getting quotations and shipping the goods is not less than one month and a half at best. Therefore the stock of the raw materials has to satisfy the requirements for one month and a half or else the factories will close down or work will be stopped."* As for accumulated spare parts inventory of LE 2.8 billion, the Minister stated that it was mainly due to past import embargoes and currency shortages resulting in stock of parts of incomplete machines that could be used as spare parts. He mentioned that a centralized specialized committee was formed to use the spare parts in any company that needs them or to determine market value in order to sell them.
- Regarding manpower and restructuring, the Minister reminded his audience that GOE was asked to create jobs and appoint all university graduates in the period 1966 to 1984. *"The burden of such manpower reaching 302,000 in number amounted to LE 900 million in 1966. It exceeded LE 2.2 billion in 1998. We can dismiss these people and make companies profitable, but we shall never do it. We shall not restructure manpower through dismissal. We presented the early retirement scheme to whoever is willing. We chose*

***employees of 20 years service so that they can be entitled to a full pension. We pay from LE 20000 to LE 35000 in addition from special funds, to ensure them a comfortable life. The pension is for the family which we protect. We cannot sacrifice our social commitment for a quick economic profit. Social peace is a very important factor leading to the realization of economic reform."***

- The Minister concluded his speech by asserting that ***"Although burdens of the past are heavy and need experience, wisdom and knowledge, which we shall not hesitate to employ for a better future, the results are encouraging. Reform of SOEs is inevitable although it is difficult. Existence of experienced, supportive men will definitely lessen the burden."***

❖ **Comments**

The Minister's speech about restructuring, its effects and importance covered many important questions. However, it seems to contradict the announced ERP to a certain extent. It is very much in favour of the Government taking the responsibility of restructuring loss making and low performing SOEs rather than leaving it to the new owners as announced in the ERP. This leads one to question the real commitment to the announced restructuring and privatization programmes and the degree of their harmony with Ministerial Policy.

In his speech the Minister confirmed, on several occasions, the GOE's refusal of both liquidation and early selling whatever the condition of the company. This policy would be perfect if restructuring did not cost money, but as it does, shouldn't benefit-cost analyses be done to compare costs and benefits of restructuring on a case-by case basis? Although the Minister's speech did contain several success stories it did not reveal how much was spent to make the turnover.

Another fact the Minister confirms is the continuation of the social responsibility of the Government. This is highly desirable as long as it does not mean a continuation of the Government influence on SOE decisions for social objectives, which was previously the cause of many of the public sector problems. The Minister also admits a shortage in faculties and institutions able to bring up and prepare candidates to perform reform of SOEs. This is not addressed at all in the ERP.

The issue of accumulated stock is also not sufficiently addressed in the ERP. The Minister states that the inventory of finished goods is an accumulation of past problems, but shouldn't this be solved by measures like clearance sales that could generate money and solve the problem? For inventory of raw materials the Minister states that stock of one and a half months is needed to cover the time preparing orders and shipping. Compared to the World figure of a maximum of seven days, he mentions, this problem ought to be addressed more clearly in the ERP.

To study restructuring at the enterprise level, managers' views have been assessed to investigate their attitudes towards several restructuring issues. A case study is also included as an annex to this chapter to illustrate how the GOE goes about restructuring and whether restructuring represents a problem in the implementation of privatization.

## 7.8 Managers' Attitudes Regarding Restructuring Issues

The Egyptian Restructuring Programme states that it is the HCs' and ACs' responsibility to restructure SOEs. This makes the managers of SOEs responsible for planning and implementing different reform measures in the SOEs, which makes their views about restructuring of special importance. This section is devoted to soliciting their views on restructuring.

### 7.8.1 Managers' Attitudes Concerning the Effectiveness of the Different Systems Applied in SOEs (Questionnaire A {Quest. A} Q38)

To rank the effectiveness of the different systems applied in SOEs and whether they need restructuring, the managers were asked to indicate the extent of effectiveness of each of six systems / policies that were presented to them. The six aspects about which the managers' views have been solicited were:

1. *Internal Control Systems*
2. *External Monitoring from Central Auditing Agency*
3. *Management Structure*
4. *Staffing Methods*
5. *Incentive Systems*
6. *Pricing Systems*

Table 7.6 summarizes and tabulates the managers' responses where the figures on the left refer to each of the above aspects.

**Table 7.6: Managers' Attitudes Concerning the Effectiveness of Control Systems Applied in SOEs**

| | Responses → / Managers' Classification ↓ | Very Effective | Effective | Neutral | Un-effective | Not at all Effective | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|
| 1 | All Managers | 0.0 | 8.4 | 14.1 | 33.8 | 43.7 | 100 | 47.8*** | 0.847 |
| | Industrial | 0.0 | 14.3 | 14.3 | 28.6 | 42.9 | 100 | 4.73 NS | D.F=3 |
| | Non-industrial | 0.0 | 7.0 | 14.0 | 35.1 | 43.9 | 100 | 36.14 | NS |
| 2 | All Managers | 2.8 | 14.1 | 31.0 | 36.6 | 15.5 | 100 | 34.7*** | 5.585 |
| | Industrial | 0.0 | 21.4 | 50.0 | 14.3 | 14.3 | 100 | 6.84 NS | D.F=4 |
| | Non-industrial | 3.4 | 12.3 | 26.3 | 42.1 | 15.8 | 100 | 22.47*** | NS |
| 3 | All Managers | 14.1 | 25.3 | 32.4 | 21.1 | 7.0 | 100 | 9.09 NS | 3.914 |
| | Industrial | 21.4 | 14.3 | 21.4 | 35.7 | 7.1 | 100 | 1.67 NS | D.F=4 |
| | Non-industrial | 12.3 | 28.1 | 35.1 | 17.5 | 7.0 | 100 | 12.8* | NS |
| 4 | All Managers | 8.4 | 16.9 | 35.2 | 29.6 | 9.9 | 100 | 19.7*** | 1.369 |
| | Industrial | 14.3 | 21.4 | 28.6 | 28.6 | 7.1 | 100 | 0.99NS | D.F=4 |
| | Non-industrial | 7.0 | 15.8 | 36.8 | 29.8 | 10.5 | 100 | 14.25*** | NS |
| 5 | All Managers | 0.0 | 11.3 | 26.8 | 29.6 | 32.4 | 100 | 21.1*** | 2.376 |
| | Industrial | 0.0 | 7.1 | 14.3 | 42.9 | 35.7 | 100 | 6.16 NS | D.F=4 |
| | Non-industrial | 0.0 | 12.3 | 29.8 | 26.3 | 31.6 | 100 | 18.15** | NS |
| 6 | All Managers | 15.5 | 9.9 | 40.8 | 23.9 | 9.9 | 100 | 21.8*** | 6.804 |
| | Industrial | 28.6 | 21.4 | 35.7 | 14.3 | 0.0 | 100 | 3.13NS | D.F=4 |
| | Non-industrial | 12.3 | 7.0 | 42.1 | 26.3 | 12.3 | 100 | 20.53*** | NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The analysis of table 7.6 reveals:

- Most managers agreed that the internal control systems applied in SOEs were either completely ineffective (43.7%) or ineffective (33 %). The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. Differences related to whether the enterprise is industrial or not proved to be statistically insignificant.

- 36.6% of the managers found the "*External Monitoring from Central Auditing Agency*" ineffective. The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. Differences related to whether the enterprise is industrial or not have proved to be statistically insignificant.
- Answers concerning the management structure reflected some differences in views. Some of the managers found the system effective while others did not (35.7% of managers in non-industrial companies thought the system was ineffective). The Chi-square tests show that the distribution of senior managers in industrial companies on this issue is similar to that which could be expected on a chance basis while it is slightly different in non-industrial companies. Differences related to whether the enterprise is industrial or not proved to be statistically insignificant
- Most managers were neutral about staffing methods used. The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. Differences related to whether the enterprise is industrial or not have proved to be statistically insignificant.
- The majority of managers agreed (62%) that the incentive systems applied were either ineffective or completely ineffective. The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. Differences related to whether the enterprise is industrial or not have proved to be statistically insignificant.
- Most managers were neutral about the pricing systems used in SOEs. The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. Differences related to whether the enterprise is industrial or not have proved to be statistically insignificant.

### 7.8.2 Managers' Expectations as to whether the Privatization and Reform Policy would Succeed in Financial Reform of SOEs (Quest. A Q29)

Senior managers were asked to indicate whether or not they expect the privatization and reform policy to succeed in the financial restructuring of SOEs. Most senior managers (73.8 %) expected success for the new privatization policy and the reform efforts in overcoming the financial problems of SOEs. The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. There were no significant differences between responses of senior managers in industrial or non-industrial companies (85.7% and 70.6% affirmative answers consecutively). Table 7.7 summarizes managers' attitudes on this issue.

**Table 7.7: Top Managers' Expectations Regarding whether the New Policies would Succeed in Financial Restructuring of SOEs**

| Responses → / Managers' Classification ↓ | Yes | No | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|
| All Managers | 73.8 | 26.2 | 100.0 | 39.4 | 0.636 |
| Industrial | 85.7 | 14.3 | 100.0 | 5.79 | D.F.=1 |
| Non-industrial | 70.6 | 29.4 | 100.0 | 8.65 | NS |

NS = Not significant

### 7.8.3 Top Management Attitudes Regarding whether Equality of Treatment is in Favour of the Public Sector or Against it (Quest. A Q32)

Senior managers have been asked to indicate their opinions as to whether the newly applied equality of treatment between public and private companies (especially in financial aspects and subsidies) is in SOEs favour or not. As shown in table 7.8, 40% of the total number of managers felt that the equality of treatment was in the favour of both private and public companies. Around 31% felt that the new policies were in the best interest of SOEs, while 30% felt they were in favour of the private sector. The responses show that some of the managers still fear equality of treatment between the private and public sectors. This is possibly because of concern that the loss of privileges and protection the public sector used to enjoy would put them at a disadvantage in the public sector. Nevertheless, a large majority of managers believed that the reforms would benefit SOEs (combining the percentages for the "In favour of SOEs" and "In favour of both public and private companies").

**Table 7.8: Top Management Attitudes Regarding whether Equality of Treatment is in Favour of the Public Sector or Against it**

| | All Managers | Managers in Industrial Co. | Managers in Non-Industrial Co. |
|---|---|---|---|
| In favour of SOEs | 31.4 | 21.4 | 33.9 |
| In favour of private sector | 22.9 | 21.4 | 23.2 |
| In favour of both public and private companies | 40.0 | 57.1 | 35.7 |
| Against interest of public sector companies | 5.7 | 0.0 | 7.1 |
| Total | 100.0 | 100.0 | 100.0 |
| $X_1^2$ | 5.7 | | |
| $X_2^2$ | 2.86 D.F.=3 | NS. | |

NS = Not significant

### 7.8.4 Managers' Attitudes Concerning Ways to Deal with Past Debts (Quest. A Q33)

Undoubtedly debt restructuring is one of the major aspects of reform. Managers' attitudes concerning how they think past debts of public sector companies should be handled have been examined using an open-ended question. Managers' responses varied reflecting multiplicity of restructuring tools the managers perceived. The most frequent answers were:

*1- No general rule but on a case-by-case bases.*

*2- Writing off debts, to start afresh without a burden of debts.*

*3- The Government must think of a solution for all the indebted companies. Among the proposed solutions was the government paying all the debts or making the National Investment Bank buy all of them.*

*4- Creditors could give a grace period and postpone their due payments for some time until liquidity problems are solved. They could also change short-term debts into long term debts.*

*5- Writing off past interest that was accumulated or at least decreasing it.*

*6- Rescheduling debts.*

*7- Immediate payment of debts as a first priority to reduce interest payments.*

*8- Selling some assets to pay off debts.*

*9- Giving public sector companies more authority to collect outstanding debt. Debt origins should then be studied, and parties which caused these debts should pay them off e.g. unpaid accounts, government, corrupt managers... etc.*

*10- Changing debts into equity, by changing creditors into shareholders according to the value of their debts.*

*11- Restructuring companies, raising productivity and lowering costs will in due time solve debt problems.*

*12- Increasing capital by selling stock to the public and using the money to pay off debts.*

The managers' responses are summarized and tabulated in the following table (table 7.9) where the figures in the top row refer to each of the above responses. The Chi-square test indicates the statistical significance of the differences between managers of industrial and non-industrial companies.

**Table 7.9: Managers' Attitudes Concerning Ways to Deal with Past Debts**

| Response → / Managers' Classification ↓ | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | 1.9 | 3.7 | 14.8 | 7.4 | 3.7 | 16.7 | 7.4 | 5.6 | 5.6 | 9.3 | 5.6 | 18.5 | 100 | 114.4 | 13.33 |
| Industrial | 0.0 | 7.7 | 0.0 | 7.7 | 0.0 | 23.1 | 7.7 | *15.4* | *0.0* | *15.4* | *15.4* | *7.7* | *100* | *3.25* | *D.F=11* |
| Non-industrial | 2.4 | 2.4 | 19.8 | 7.3 | 4.9 | 14.6 | 7.3 | 2.4 | 7.3 | 7.3 | 2.4 | 22 | 100 | 18.38 | NS |

NS = Not significant

The numerous choices the managers made reflect the numerous ways they perceive to handle past debts. The most frequent answer (18.6%) among senior managers has been "*increasing capital by selling stock to the public and using the money to pay off debts.*" Managers of non-industrial companies have agreed with this view (22%). However, managers in industrial companies found "*rescheduling of debts*" to be the most appropriate method.

## 7.9 A Case Study on Restructuring: The Egyptian Company for Refractories

The Egyptian Company for Refractories is one of the Egyptian PEs that was chosen by the GOE as an early candidate for restructuring under ERP. This section describes the case, demonstrating how the GOE deals with the restructuring problem. It offers an example of the different measures that are taken in the case of restructuring followed by a brief analysis of the case. The objective is to investigate the procedures and problems in implementing restructuring measures in loss-making SOEs.

First, brief information about the company is presented. The different analyses that were made by the consultants are than summarized. Next the key findings and the final recommendations the consultants reached are discussed. The case concludes with the researcher's comments on the case.

### 7.9.1 Company Background

The Egyptian Company of Refractories is one of the companies operating under Law 203/1991. It is a specialized refractories company that has several plants and mines. Its main activity is producing a variety of refractories products. The company is a loss-making manufacturing company that consists of two major out-dated plants (El-Tebbin and Alexandria plants), two new plants (El-Nozha and Helwan plants) and several mines. The company was the subject of a preliminary study by the Partnership in Development Project during 1993. The findings were contained in a report submitted to the holding company on December 21, 1993. The report discussed several privatization options and suggested ways to increase the viability of a near-term privatization and increase the proceeds to the holding company. This annex presents a summary of the measures taken by the consultants, their recommendations and what the GOE action was.

### 7.9.2 A Summary of the Analyses that were Carried Out

To study the company the work group performed the following analyses:

- **Legal Analysis**: The legal analysis aimed to review the legal and regulatory issues currently facing the company and to examine the legal issues that may act as constraints to the company's privatization.

- **Financial Analysis**: This analysis included an evaluation of past performance and the debt burden presently facing the company. It also undertook projections of the company's performance for the coming five to ten years.

- **Market Analysis**: The market analysis aimed to assess the present market for the company's products and to estimate the demand forecast for the coming years. The analysis also aimed to assess the present market share of the company and recommend a marketing strategy.

- **Land, Buildings and Equipment**: This analysis aimed to determine the capacity, utilization and limitations of the land, plants, and mines. The analysis also determined the current value and extent of future needs of the different plants and mines.

- **Technical Evaluation and Valuation of Production Equipment and Operational Assessment**: This analysis aimed to assess the entire manufacturing cycle. In so doing, it estimated the replacement value of the equipment, recommended improvements, and projected the company's future equipment needs.

- **Management and Human Resources**: This analysis aimed to review the current organizational structure, workforce, and policies and recommended improvements.

- **Privatization Options**: Examination of the aspects listed above provided the holding company with an analysis of the options available to move towards privatization. The final report included several recommendations concerning the different aspects.

### 7.9.3 Major Findings of the Project Team

The following is a summary of the major findings of the study team. It shows the major problems the project team identified and that need to be addressed:

- **Technical Problems**
  - El Tebbin and Alexandria plants were outdated, fully depreciated with almost no book value and no undepreciated market value for the machines and equipment.
  - El Tebbin and Alexandria plants produced low alumina products at a low quality and inconsistent standard.
  - El Nozha plant had not been able to accomplish its performance tests for high alumina above 70 per cent and have the product certified by A.P. Green (an agency specialized in company evaluation).
  - El Nozha plant is technically capable of producing high alumina refractories comparable to international standards.
  - Helwan plant produces magnesite-chrome refractories which are below internationally acceptable standards. This is because it is higher in silica and lime but lower in chromite.

- The company is cost competitive.
- The mines have no proven reserves by international standards.
- The mines do not perform sufficient exploration work (e.g. drilling) essential for planning the raw material supply for the plants. It is also important for the mines' own planning.

❖ **Marketing Problems**

- The 1993 Egyptian capacity of 342 thousand tons is nearly double the demand for the product, which is 199 thousand tons.
- Shift from low alumina to high alumina of increasing percentage is causing a constant shift to better, more sophisticated products required by the market, which would require the company to constantly adapt and improve standards.
- Shift from brick to monolithic linings had occurred internationally and would happen shortly in Egypt. This would also require further technical/ marketing innovation from ECR.
- Low quality products of El Tebbin and Alexandria damage the image of the company.
- The company is unable to compete in the local market with the imported quality of high alumina and magnesite, which have been increasing during the past few years. This is due to superior product quality and after sales technical assistance, which are provided by the competitors. The company is unable to capture an increased market share from the cement sector due to their technical requirements.
- The company is not producing a wide variety of refractory products thus seriously damaging its chances of marketing success.
- The company is not utilizing the A.P. Green contract to its advantage. This should be achieved by adding new, needed products.
- The company is restricted by Government purchasing regulations through tender procedures to buy international raw materials at the cheapest price. This could sometimes contradict the desired quality of the final output.

❖ **Financial Problems**

- The company was producing / selling at 21 per cent of its capacity in 1993 / 94. If it continued at this rate the financial burden of the unutilized capacity of 80 per cent, along with other problems would result in a cumulative cash deficit of LE 216 million by the end of 1998. This made the survival of the company very questionable.
- The company was facing a severe liquidity crisis with a liquidity ratio at 0.33:1. The causes of its liquidity problems are extremely high inventory turnover levels (17.8 months) and a long receivables collection period (10 months).
- The company has a high debt of LE 338 million because of high borrowing to finance unutilized excess capacity.
- The Alexandria plant had been making losses during the years 1995 to 1998 and despite a profit in 1993 looked vulnerable in product profitability analyses.
- The El Tebbin plant's profitability was negligible despite the fact that there was no depreciation deduction.

❖ **Labour Problem**

- The company was heavily overstaffed with around 4,000 employees. The consolidated redundancy level was 48 per cent, mainly concentrated in the mines.

❖ **Environmental Problems**

- The environmental situation could not be remedied in the two old plants.
- The mines were not complying with Law 91/1959 for mines and quarries health and safety protection.

### 7.9.4 Options Available for the Company According to the Project Team

The work team identified two main options available for the company to solve these problems.

**A) Restructuring Option**

**B) Immediate Privatization Option**

The two options will be discussed briefly in the following section:

A) **Restructuring Option**

This option consisted of physical and financial restructuring of the company

❖ **Physical Restructuring**

Physical restructuring included restructuring of the mines and the old plants

□ **Restructuring of the Mines**

The technical analysis found that the mines have no proven reserves by international standards. Also, they do not perform sufficient in-mine exploration work, very much needed to produce the raw material specified by the plants. The mines could benefit tremendously from foreign expertise.

Below are the options available to the holding company to separate the mines from the rest of the company's activities:

- Mines to remain with the holding company
- Mines to be leased jointly to an Egyptian entrepreneur
- Mines to be leased separately to Egyptian entrepreneurs

Recommendation of the work group was for the mines to remain with the same holding company after establishing a new company that would be in charge of the professional operations of the mines. This would help the holding company solve the problem of limited expertise and time to manage the mines directly. The new company could, initially, enter into a management agreement with a foreign operator to manage for a period of time one or both mines in return for a percentage of the operating profits. Part of the agreement should focus on the desire to export raw materials and also to actively market the raw materials locally.

The advantages of this approach were:

- It would establish a competitive market for supply of kaolin clays in Egypt and thus encourage all producers to improve the quality of their product and reduce prices.
- The mine operators would more eagerly look for export markets -- and improve their operations to meet the demands of those markets.

The main disadvantage of this approach, as mentioned by the work team, was that the refractory companies would no longer have control of the mines and therefore no influence over the private companies making refractories from those raw materials. This may not be important in the long term since the Nozha and Helwan plants should be able to supplant these other companies in the market by offering a better product at a competitive price.

- **Restructuring of the Old Plants**

As outlined in the major findings the old plants had to be separated from the new ones for technical, marketing, financial and environmental reasons. Both plants produced hollow ware and low quality refractories using the "plastic" process. It was thought that with the right formulations and if all costs were correctly accounted, both the Nozha and Helwan plants could produce much better bricks at lower cost than these plants. The better quality would improve ECR's image with customers and thus make selling of higher alumina products easier.

Also a solution had to be found for the hollow ware product line. These products were used by the steel mills for the old process of pouring ingots. The conversion to continuous casting had made the demand for this type of refractory far less than in the past. However, some demand would continue. ECR's sales of these products were only L.E 210,000 in 1992/93 so financially it was not an important product line.

The options available for these two old plants were as follows:

- Let Sornaga be the only supplier of these products. They apparently have the right equipment and, given the decline in demand for these products due to installation of continuous casting, could supply the needs of the steel companies.
- The two old plants could then be closed and the employees adequately compensated.
- The two plants could be sold as going concerns to local investors.

The work team's final recommendation was to choose the first two options. The two options are complementary and present the best solution to the previously outlined issues. The third option was rejected since it would be difficult to find an entrepreneur willing to buy technically obsolete equipment in order to produce a product that could not be sold in the market when the supply is twice the demand.

❖ **Financial Restructuring**

The proposed restructuring depended on positioning the company as a major producer of quality refractories serving a regional market that covers, in addition to the Egyptian market, the Arab, Middle Eastern, and to a lesser extent, the Southern European markets. This was expected to expand the company sales to a level that would allow it, with proper financial restructuring, to become a viable profitable entity that can, at a later stage, attract private investors. This option assumed that the above recommendations were implemented and production was limited to Helwan and EI Nozha plants.

Even after applying the above measures, a major debt restructuring was required to ensure that the company was left with a debt burden that can be served by its cash flow while still yielding acceptable profits to the shareholders. The restructuring required a combination of debt / equity swaps, debt forgiveness, and rescheduling of loans.

In working out the assumptions for the financial restructuring it was necessary to take into account the present policies of public sector banks, who were company's main creditors. The National Investment Bank (NIB) which is the largest lender to the company, is a Government body which is funded from direct Government sources including social security funds. Its policies do not allow it to write-off any debt. However, it has recently been involved in a number of large debt / equity swaps. The USAID loan of $20.8 million represents a special problem that had to be addressed as soon as possible, since it could have a substantial effect on future performance.

The loan was originally re-lent to the company from the General Authority for Industrialization (GAFI) in 1987 in US dollars to be repaid in Egyptian pounds at the rate prevailing at the time of repayment; i.e. the company assumed the exchange risk. It carried a fixed interest rate and had a grace period of four and a half years. Repayment was over ten additional years. The loan has been carried on the books of the company at an exchange rate of US$1= LE 0.84.

As the LE / US$ rate deteriorated and the interest on the dollar declined rapidly, ECR realized that the loan was quickly becoming a huge burden in terms of amount and interest rate. It approached GAFI and negotiated a deal to keep the loan servicing (both interest and repayment) at the original exchange rate. The promissory notes related to these payments were amended accordingly. The Ministry of Finance (MOF), however, objected to this arrangement because it switched the financial burden from the company to the Treasury and had not been resolved and was expected to go to court.

The project team's opinion was that the company's chances of winning the case is slim since the original agreement supports the MOF point of view. On the other hand, it was certainly impossible for the company to continue serving what is in reality a $ loan at an interest rate twice the market rate. Thus, it was suggested that the company accepts the current valuation of the loan at the current exchange rate provided that the MOF accepts to assume all future exchange risk and to reschedule the loan for repayment over a 15 year period with 2-year grace period at an interest rate of 13 per cent. The second major loan the company had was a Russian loan, at soft terms which could be maintained.

The project team assumed that the bank overdraft due to public sector banks could probably be reduced by the amounts already provisioned at the banks. They estimated this reduction to be in the order of 30 per cent. They proposed that the remaining part be rescheduled at reduced interest rates.

**Major Assumptions Made by the Project Team for the Financial Restructuring**

1) **Foreign manufacturer:** It was assumed that ECR plants in El Nozha and Helwan would either be acquired or managed by a technically capable foreign refractory manufacturer who does not have a strong market penetration in the Middle East. This would result in a substantial change in strategic direction, which was to develop a new *marketing strategy* based on:

- Selling solutions to customer needs for refractories.
- Building loyalty of domestic customers by focusing on improving their cost/productivity rather than maximizing ECR's tonnage and paying more attention to customers' requirements.
- Until capacity fills, take all business that covers variable costs and provides some contribution to fixed costs.

- Focusing export development in big markets such as Italy and Turkey and competing on the basis of superior quality at equal or lower price.
- Pushing other local suppliers (including Sornaga) out of the market by offering superior products at equal price.

Substantially upgrade the product line:

- Add monolithic, especially for ladle bottoms and tun dishes
- Develop high alumina bricks for cement kilns
- Develop a low cost, good quality, low alumina firebrick that can be made in Helwan or Nozha to replace the products now made in EI Tebbin and Alexandria
- Develop magnesite products that meet international standards
- Develop specialized clays (raw and calcined) for export

Change operating strategy:

- Ship only products that meet or exceed the agreed specification. Aim for zero defects and zero claims
- EI Tebbin and Alexandria plants to be spun off

It was further assumed that:

- ECR obtains Dekheila ladle and tun dish business in 1995/1996
- ECR displaces Sornaga at Iron & Steel by end of 1995/1 996, converts ladles to 80 per cent alumina in 1994/1995, and captures 50 per cent of imported high alumina business
- At Delta, National, and Copperworks, ECR keeps current high share plus all of the Sornaga business plus 80 per cent of currently imported high alumina
- ECR improves magnesite and high alumina for cement production and eventually acquires most of the business

Production will be distributed between Helwan complex and EI Nozha plant according to the following rules:

- 80 per cent alumina is produced in Alexandria
- Alumina exports are produced in Alexandria plant. Castables are produced in Helwan
- 65 per cent alumina are divided between Helwan and new Alexandria plants

* Low alumina products and mortars formerly produced at Tebbin will be produced at Helwan complex and those formerly produced at Old Alexandria plant will be produced at EI Nozha plant
* The sales quantities per ton per product with local and export prices remain stable at the rates provided by the company during the production analysis phase.

2) **Working Capital**: Working capital requirements were calculated on the basis of the current operating levels for each individual plant according to the following norms:

* Accounts Receivable: receivables to be decreased by 10 per cent annually from current levels to reach a minimum of three months of net sales.
* Inventory: The following assumptions were made concerning inventory

**Table 7.10: Inventory Assumptions**

| Inventory | |
|---|---|
| Basic raw materials and packing materials | 6 months of consumption |
| Supplies | 2 months of consumption |
| Spare parts | Spare parts are gradually decreased from current levels |
| Work in progress | 7 days of cost of manufactured goods |
| Finished goods | Finished goods are gradually decreased from current lev |

*Source: Egyptian Company for Refractories Final Report*

* All other current assets and liabilities are assumed to be constant at their historic values through the projection period.

2) **Sales of Fixed Assets:** This item covers the sale of fixed assets of EI Tebbin and the Old Alexandria plants. It includes the sale of land, machinery, equipment, tools, furniture, and vehicles. For the EI Tebbin plant the sale of fixed assets totals LE 7.9 million; for the Old Alexandria plant the sale of fixed assets total is LE 7.2 million.

3) **Compensation Packages:** This scenario entails closing down two plants and compensating employees. Compensation package for employees in Tebbin plant was estimated at LE 5.4 million. For Old Alexandria plant the compensation package total for LE 4.5 million.

### ∢ The Company's Outstanding Debts

The company's outstanding debts as of June 30, 1993 were as follows:

**Table 7.11: Outstanding Debts** *(LE thousands)*

| | Principle | Overdue Interest | Forex | Total |
|---|---|---|---|---|
| National Investment Bank (NIB) | 135.957 | 13.426 | --- | 149.383 |
| USAID | 17.461 | 13.225 | 52.798 | 83.484 |
| Russian loan | 6.067 | 588 | --- | 6.655 |
| Over Draft | 98.638 | --- | --- | 98.638 |
| Total | 258.123 | 27.238 | 52.798 | 338.159 |

*Source: Egyptian Company for Refractories Financial Report*

### ∢ The Final Recommendations for the Financial Restructuring

- The NIB loan should be totally converted into equity. The valuation of the corresponding share NIB would acquire as a result of this swap had to be agreed between the two parties, the holding company and NIB, on the basis of the expected future earnings of the company. The swap should be implemented as an increase in capital to obtain full tax benefits.
- USAID loan carries a 13 per cent interest rate with repayment starting in mid 1997 over a period of 10 years. The Government assumes foreign exchange risk.
- The Russian loan is already carrying soft terms and can be maintained as it is.
- The overdraft from the public sector banks is to be reduced by 30 per cent and the remainder of LE 69 million is to be converted to a long-term loan carrying an interest of 12 per cent. Payment would start in mid 1997 over a period of five years.
- An additional loan of LE 4.5 million needed in 1995 to meet short falls in the cash flow. The loan is to carry an interest rate of 13 per cent and is to be repaid starting in 1998 over a four-year period.

Table 9.12 projects the cash flow of the company as it is, without the financial restructuring resulting in cumulative cash deficit of LE 216 million by 1998, then reaches a deficit of LE 329 million by the year 2002.

The proposed restructuring plan should result in a marked improvement in ECR prospects. It should, however, be emphasized that the key element to success is finding the right international operator who can commit to achieving the projected sales volume.

Table. 9.13 gives the projected income statement for ECR. The income statement shows a rapid buildup of sales from LE 41 .2 million in 1994, LE 183.9 million in 1998, an increase of 4.4 times over a four year period (45 per cent compounded annually). Obviously this could only be achieved through massive exports.

According to this scheme the company would continue showing losses up to 1996. In 1997 profits would reach 9 per cent of sales (LE 13.3 million) and would increase rapidly to stabilize at 20 per cent of sales (LE 36.7 million) by 2002. Because of the high capital (after converting the NIB loan to equity) the tax burden would be small, as the company would take advantage of the associated tax deduction. Financial charges (interest) would start at a high of LE 20.4 million in 1995-1997. They would then decline as repayment of debt starts, declining to LE 15.2 million in 1999 and to LE 6.3 million in 2002.

Table 9.14 shows the company's expected cash flow, according to this option. As evident, ECR is expected to enjoy a positive cash flow in all years of projection. It will however need a new loan of LE 4.5 million in 1995. In all subsequent years, the company should not suffer from liquidity problems. In fact it would exhibit a healthy debt service coverage ranging from 1.4 in 1996 to 2.5 in 2002. This should allow the company to pay dividends from 1997.

Table 7.12

| Cash flow | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|---|
| **<u>Sources of Funds</u>** | | | | | | | | | |
| Net Profit | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Depreciation | 11,340,130 | 14,743,675 | 14,657,475 | 14,201,375 | 14,261,375 | 14,229,575 | 14,112,975 | 14,208,975 | 13,822,570 |
| Amortization | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Adjustments for non Cash items | | | | | | | | | |
| Residuals Value | | | | | | | | | |
| Generated Cash | 11,340,130 | 14,743,675 | 14,657,475 | 14,201,375 | 14,261,375 | 14,229,575 | 14,112,975 | 14,208,975 | 13,822,570 |
| **<u>Other Sources of Funds</u>** | | | | | | | | | |
| Sale of fixed Assets | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Share Capital / Grants | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Local Long Term Loan | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Local Long Term Loan | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bank Overdraft | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Sources of Funds | 11,340,130 | 14,743,675 | 14,657,475 | 14,201,375 | 14,261,375 | 14,229,575 | 14,112,975 | 14,208,975 | 13,822,570 |
| **<u>Application of Funds</u>** | | | | | | | | | |
| Capital Expenditure | 1,000,000 | 0 | 0 | 1,600,000 | 1,000,000 | 0 | 0 | 1,600,000 | 1,000,000 |
| Loan Repayment | 24,045,042 | 24,045,042 | 24,045,042 | 24,045,042 | 24,045,042 | 24,045,042 | 24,045,042 | 24,045,042 | 23,286,667 |
| Interest | 37,570,706 | 34,915,750 | 32,260,794 | 29,605,838 | 26,950,882 | 24,295,926 | 21,640,970 | 18,986,014 | 16,350,017 |
| Increase/ Decrease in Working Capital | 8,986,032 | (2,388,893) | (2,295,488) | (1,531,843) | (2,298,406) | (2,712,118) | (2,440,899) | (2,197,462) | (2,884,139) |
| Taxes | | | | | | | | | |
| Total Application of Funds | 71,601,780 | 56,571,899 | 54,010,348 | 53,719,037 | 49,697,518 | 45,628,850 | 43,245,113 | 42,433,594 | 37,752,546 |
| Net Cash Flow | (60,261,650) | (41,828,224) | (39,352,873) | (39,517,662) | (35,436,143) | (31,399,275) | (29,132,138) | (28,224,619) | (23,929,976) |

Table 7.13

INCOME STATEMENT

| | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|---|
| Revenues | | | | | | | | | |
| Net Sales | 41,245,127 | 59,352,915 | 92,495,856 | 145,129,955 | 183,979,813 | 183,979,813 | 183,979,813 | 183,,979,813 | 183,979,813 |
| **Total Revenues** | 41,245,127 | 59,352,915 | 92,495,856 | 145,129,955 | 183.979.813 | 183,979,813 | 183,979,813 | 183,979,813 | 183,979,813 |
| Direct operating Costs | | | | | | | | | |
| Direct Variable Costs | | | | | | | | | |
| Basic Raw Materials | 10,773,401 | 18,336,514 | 31,271,415 | 47,954,370 | 59,950,745 | 59,950,745 | 59,950,745 | 59,950,745 | 59,950,745 |
| Other Raw Materials | 99,320 | 117,143 | 146,527 | 192,943 | 217,142 | 217,142 | 217,142 | 217,142 | 217,142 |
| Packing Materials | 431,455 | 917,770 | 2,043,123 | 4,173,615 | 6,006,296 | 6,006,296 | 6,006,296 | 6,006,296 | 6,006,296 |
| Spare Parts | 3,585,118 | 4,484,332 | 6,092,362 | 8,722,011 | 10,508,930 | 10,508,930 | 10,508,930 | 10,508,930 | 10,508,930 |
| Main tailrace | 499,001 | 609,935 | 803,318 | 1,116,279 | 1,314,210 | 1,314,210 | 1,314,210 | 1,314,210 | 1,314,210 |
| Lubricant Oil | 366,754 | 438,828 | 560,723 | 755,464 | 867,170 | 867,170 | 867,170 | 867,170 | 867,170 |
| Energy | 1,744,862 | 2,281,642 | 3,211,131 | 4,854,833 | 6,104,885 | 6,104,885 | 6,104,885 | 6,104,885 | 6,104,885 |
| Power | 2,428,767 | 2,994,698 | 4,027,773 | 5,586,250 | 6,580,698 | 6,580,698 | 6,580,698 | 6,580,698 | 6,580,698 |
| Miscellaneous | 61,227 | 75,187 | 99,662 | 139,364 | 164,896 | 164,896 | 164,896 | 164,896 | 164,896 |
| A. P. Green Roya Hies | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Sub- total (Direct Variable Costs) | 19,989,905 | 30,256,050 | 48,256,035 | 73,495,130 | 91,714,971 | 91,714,971 | 91,714,971 | 91,714,971 | 91,714,971 |
| Direct Fixed Costs | | | | | | | | | |
| Labor Wages | 5,217,800 | 5,217,800 | 5,217,800 | 5,217,800 | 5,217,800 | 5,217,800 | 5,217,800 | 5,217,800 | 5,217,800 |
| Over-all Maintenance | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Depreciation | 10,856,300 | 14,259,745 | 14,259,745 | 13,970,245 | 13,863,645 | 13,863,645 | 13,831,445 | 13,882,245 | 13,882,245 |
| Total Direct Fixed Costs | 16,074,600 | 19.477.545 | 19,477,545 | 19,196,649 | 19,081,445 | 19,081,445 | 19,049,245 | 19,040,045 | 19,100,045 |
| Cost of Manufactured Goods | 36,063,905 | 49,733,595 | 17,733,480 | 92,691,375 | 110,796,416 | 110,796,416 | 110,764,216 | 110,755,016 | 110,815,016 |
| Gross Profit | 5,181,222 | 9,619320 | 24,762,269 | 52,438,363 | 73,183,397 | 73,183,397 | 73,215,597 | 73,224,797 | 73,164,797 |
| Indirect Operating Cost | | | | | | | | | |
| Indirect Variable Cost | | | | | | | | | |
| Administrative Expenses | 2,483,027 | 3,096,065 | 4,155,667 | 5,960,320 | 7,063,894 | 7,063,894 | 7,063,894 | 7,063,894 | 7,063,894 |
| Selling Expenses | 681,602 | 908,356 | 1,490,899 | 2,322,022 | 2,919,738 | 2,919,738 | 2,919,738 | 2,919,738 | 2,919,738 |
| Total Indirect Variable Cost | 3,165,028 | 4,054,596 | 5,646,565 | 8,316,170 | 9,983,632 | 9,983,632 | 9,983,632 | 9,983,632 | 9,983,632 |
| Indirect Fixed Cost | | | | | | | | | |
| Sales- Salacious | 474,500 | 474,500 | 474,560 | 474,500 | 474,500 | 474,500 | 474,500 | 474,500 | 474,500 |
| Promotions | 0 | 350,003 | 350,060 | 650,000 | 350,000 | 350,000 | 350,000 | 350,000 | 350,009 |
| Administration & Finance Salaries | 1,230,300 | 1,230,300 | 1,230,300 | 1,230,300 | 1,230,300 | 1,230,300 | 1,230,300 | 1,230,300 | 1,230,300 |
| Total Indirect Fixed Costs | 1,703,300 | 205,844 | 2,040,900 | 295,460 | 2,054,800 | 2,054,800 | 2054,800 | 2,054,800 | 2,054,800 |
| Total Indirect Operating Costs | 4,870,123 | 6,109,300 | 7,701,365 | 10,272,976 | 12,038,432 | 12,038,432 | 12,038,432 | 12,038,432 | 12,834432 |
| Operating Cost | 40,934,033 | 55,842,992 | 75,434,945 | 102,964,352 | 122,834,848 | 122,834,848 | 122,032,648 | 122,793,443 | 122,853,448 |
| Operating Profit | 311,094 | 3,509,920 | 17,060,911 | 42,165,003 | 61,144,965 | 61,144,965 | 61,177,165 | 61,186,365 | 61,126,365 |
| Non Operating Expenses | | | | | | | | | |
| Financial Charges | 9,901,988 | 20,388,975 | 20,388,975 | 20,388,975 | 18,224,305 | 15,240,578 | 12,229,851 | 9,273,124 | 6,325,959 |
| Amortization | 62,219 | 701,939 | 3,412,182 | 8,433,161 | 12,228,993 | 12,228,993 | 12,232,433 | 12,237,273 | 12,225,273 |
| Foreign Management Royalty | 9,905,530 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Compensation Packages | 19,669,796 | 21,090,960 | 23,801,158 | 28,822,133 | 30453,298 | 27,469,571 | 24,492,284 | 21,510,397 | 18,551,232 |
| Sub- total Profits before Taxes | (19,558,643) | (17,581,037) | (6,704,246) | 13,343,667 | 30,691,669 | 33,675,394 | 36,684,881 | 39,675,968 | 42,575,132 |
| Taxes | 0 | 0 | 0 | 0 | 835,979 | 2,089,144 | 3,353,129 | 4,609,385 | 5,827,035 |
| Net Profit after Taxes | (19,558,643) | (17,581,037) | (6,704,246) | 13,343,667 | 29,855,688 | 31,586,249 | 33,331,752 | 35,066,582 | 36,748,098 |
| Return on Sales | | | | 9% | 16% | 17% | 18% | 19% | 20% |

Table 7.14

| Cash flow | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|---|
| Sources of Funds | | | | | | | | | |
| Operating Profits | 311,094 | 3,509,923 | 17,060,911 | 42,165,803 | 61,144,965 | 61,144,965 | 61,177,165 | 61,186,365 | 61,126,365 |
| Depreciation | 10,856,200 | 14,259,745 | 14,259,745 | 13,978,245 | 13,863,645 | 13,863,645 | 13,831,445 | 13,822,245 | 13,882,245 |
| Amortization | | | | | | | | | |
| Adjustments for non Cash items | | | | | | | | | |
| Residuals Value | | | | | | | | | |
| Generated Cash | 11,167,294 | 17,769,668 | 31,320,656 | 56,144,048 | 75,008,610 | 75,008,610 | 75,008,610 | 75,008,610 | 75,008,610 |
| Other Sources of Funds | | | | | | | | | |
| Sale of fixed Assets | 15.304.328 | | | | | | | | |
| Share Capital | | | | | | | | | |
| Local Long Term Loan | | 4,500, 000 | | | | | | | |
| Local Long Term Loan | | | | | | | | | |
| Bank Overdraft | | | | | | | | | |
| | 15,304,328 | 4,500,000 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Sources of Funds | 26,471,622 | 22,269,668 | 31,320,656 | 56,144,048 | 75,008,610 | 75,008,610 | 75,008,610 | 75,008,610 | 75,008,610 |
| Application of Funds | | | | | | | | | |
| Foreign Management Royalty | 62 ,219 | 701,985 | 3,412,182 | 8,433,161 | 12,228,993 | 12,228,993 | 12,235,433 | 12,237,273 | 12,225,273 |
| Capital Expenditure | 1,000,000 | 0 | 0 | 1,000,000 | 1,000,000 | 0 | 0 | 1,.000,000 | 1,000,000 |
| Royalties | | | | | | | | | |
| Labor Compensation Package | 9,905.530 | | | | | | | | |
| Increase/ Decrease in Working Capital | 5 ,638,526 | 1,072,433 | 4,362,636 | 9,854,669 | 7,642,301 | (2,432,226) | (2,188,710) | (1, 723,657) | (104,241) |
| Loan Repayment | 0 | 0 | 0 | 11,554,194 | 24,233,389 | 24,233,389 | 24,233,389 | 24,233,389 | 16,203,729 |
| Interest | 9, 901,988 | 20,388,975 | 20,388,975 | 20,388,965 | 18,224,305 | 15,240,578 | 12,256,851 | 9, 273,124 | 6,325,959 |
| Taxes | 0 | 0 | 0 | 0 | 835,979 | 2,089,144 | 3,353,129 | 4,609,385 | 5,827,035 |
| Total Sources of Funds | 26,505,262 | 22,163,393 | 28,163,793 | 51,230,999 | 64,164,967 | 51,359,878 | 49,890,092 | 49,629,514 | 41,477,754 |
| Net Cash Flow | (36,641) | 106,275 | 3,156,863 | 4,913,049 | 10,843,643 | 23,648,732 | 25,118,518 | 25,379,095 | 33,530,855 |
| Cumulative Cash Flow | 2,074,359 | 2,180,634 | 5,337,497 | 10,250,546 | 21,094,156 | 44,742,921 | 69,861,439 | 95,240,534 | 128,771,389 |
| Debt service coverage | 1.1 | 0.8 | 1.4 | 1.5 | 1.5 | 1.5 | 1.6 | 1.7 | 2.5 |

### B) Immediate Privatization Option

Egyptian Company for Refractories could be privatized immediately as follows:

i) The mines to be kept with the holding company

ii) The old plants to be closed

iii) The two new plants to be privatized

In parallel to A and B above which have been outlined in detail under option one, the two new plants in Nozha and Helwan could be immediately privatized.

**Nozha Plant**: This modern plant was designed to produce a nearly full range (up to 82 per cent alumina content) of alumina refractories that meet international standards. To be successful this plant would have to be well managed (preventive maintenance is an especially important factor). Financially, it needs to also operate at a reasonable level of utilization.

**Helwan Plant**: This plant can produce a range of alumina refractories up to 65 per cent alumina and a nearly full range of magnesite refractories. For this plant, the key success factor is careful management of operations. Unlike Nozha, many operations must be manually controlled. If this is done well, their products may also meet international standards for quality. The alternative immediate privatization options that need to be considered are as follows:

❖ **First Alternative: Separate Privatization**

The work team felt that separate privatization of the two new plants would offer the following advantages:

- The operators of the refractory plants could focus on development and sale of refractories with little distraction from the mines. They would likely feel freer to import raw materials if necessary to make a superior product.
- The steel companies, who are very keen on ensuring competitive suppliers within Egypt; could buy only from the two modern plants (leaving out Sornaga and the other private suppliers) with confidence that they still have at least two independent suppliers within Egypt.
- Operators at both Helwan and Nozha would realize the need and importance of producing high quality products that they could sell in export markets.

- Potentially two different international producers of refractories could be drawn into Egypt. Egyptian consumers would likely benefit from a better selection of competitive products.

On the other hand they expected that separate privatization offer would have the following disadvantages:

- Neither Nozha nor Helwan could offer a complete product line, especially for cement companies who need the high alumina products that Nozha can produce and the magnesite products made by Helwan. The two companies might cooperate to meet these needs especially within Egypt. Outside Egypt, their cooperation might be limited if at least one of the buyers makes the complementary product elsewhere.
- The competition from the two modern plants would likely drive Sornaga and the private sector companies out of the refractories business.
- They expected, however, that the ultimate financial impact on the holding company may in fact be better if two strong companies could emerge in place of the two weak companies that existed.
- Finding two international companies to buy in Egypt may be difficult. Both would recognize that they would have to export considerable volume to be successful.

❖ **Second Alternative: Joint Privatization**

The joint privatization of the two plants would permit the company to offer a relatively complete product line to the market. However, within the Egyptian market the company would not be likely to capture as high a market share as the Nozha and Helwan plants could together capture if operated separately. Additionally, it would be difficult to sell both plants together because of the large investment needed.

❖ **Third Alternative: ElNozha for Export, Helwan for Local Market**

The idea behind this alternative is that the Helwan plant, being in Cairo, could easily sell to the metallurgical companies in Helwan and also to some of the cement companies. El Nozha plant, because of its ability to produce high alumina and its location, would be well suited for the export market. Due to the supply in the local market being twice the demand, it made sense for the plants not to compete but rather separately sell their products to different buyers in different countries.

The disadvantage of this alternative was that it may reduce the sale value of the EI Nozha plant, as the buyer would be expected to provide all the value attributable to market success. Meanwhile the Helwan plant might still have to export to achieve full utilization because the steel companies would still split business between it and Sornaga.

**Final Recommendations**

Finally the project tem reached the recommendations set out below.

- It is recommended that the GOE starts the privatization option with the immediate privatization of both new plants and at the same time implement the restructuring options outlined above for the old plants and mines.
- It is further recommended that the GOE offer the various potential buyers the opportunity to acquire either one or both plants or alternatively manage one or both plants under a management contract with an option to buy at a future date at a pre-agreed price. Maximum flexibility on the part of GOE is recommended in order to conclude complex and time consuming transaction(s).
- Sale negotiations should be based on the positive value projection for the company after payment of all debts (Scenario 2 of the company valuation). In this case no debt rescheduling will be required.

On the other hand, if the results of the Government privatization efforts are a management contract(s) with an option to buy, the company becomes a restructuring candidate. In this case financial restructuring outlined in option one, will have to be implemented to resolve the financial position of the restructured company that will continue after restructuring, with two new plants, under new management.

❖ **Recommendations Concerning Privatization Methods**

- The privatization of ECR is a privatization through the sale of assets.
- The privatization through the sale of shares is not foreseen in this case, as it will further complicate an already highly complex privatization operation.

- It is recommended that the sale of assets be done through private placement with selected international refractories companies. This would require strong and active marketing, including visits to the potential candidates in order to solicit their involvement in ECR as managers or investors. This would also require direct and discreet negotiation between the parties.

### 7.9.5 Final GOE Action and Researcher Comments

Up till the end of 1998, the recommended plan had not been implemented and the company was left with no change. Knowing that the full report including the different options was presented to the GOE in December 1993, one wonders whether the different options and recommendations are still valid.

**Researcher Comments**

The case is an example of a heavily indebted loss-making SOE. The Egyptian Government depended on professional consultants to find out available options and make recommendations. This is a favourable attitude that allows utilization of professional expertise to help find privatization options that could maximize prospects of the company. Transparency is a pre-requisite of this approach. It is also recommended that *independent consultants evaluate the report to discover any* shortcomings.

As evident from the case study the consultants arrived of a group of recommendations that are a mixture of restructuring of the mines, spinning off the old plants and privatization of the modern ones. They recommended that the sale of the old plants take place as a sale of assets and that the privatization of the new ones could either be sold as going concerns, leased or managed through management contracts. Management contracts were also recommended for the mines to benefit from foreign expertise. The consultants offered the different options with an accompanying estimation of cash flows and financial position for each option.

It is the researcher's view that the report has covered all the options and has reached adequate recommendations. Yet, there are a few problems that have been mentioned in the report but have not been addressed. Many of these problems as evident in Chapter Seven are common in many other SOEs. This calls for more attention to these problems and more reflection in the ERP. Namely, they are:

- The company is facing a severe liquidity crisis with its liquidity ratio at 0.33:1. The causes of its liquidity problems are extremely high inventory to turnover levels (equivalent to 17.8 months of sales) and an extremely long receivables collection period (10 months).
- The company is heavily overstaffed with around 4,000 employees. The consolidated redundancy level is 48 per cent, mainly concentrated in the mines.
- The company is restricted by Government purchasing regulations through tender procedures to buy international raw materials at the cheapest price. This could sometimes contradict the desired quality of the final output. This reflects a continuation of the Government influence on internal company decisions.

Other problems in the company cited by one of the managers in an interview were:

- The company is not producing a wide variety of refractory products thus seriously damaging its chances of marketing success.
- The company is not utilizing the A.P. Green contract to its advantage. This could be achieved by adding new products to meet A.P Green's requirements.

Furthermore, although this report was issued in December, 1993, nothing had happened until the end of 1998. This slowness of implementing restructuring and privatization plans is typical of Egyptian practice. It either reflects difficulty of implementing restructuring plans, a reluctance to pursue them or unavailability of sufficient funds. Slowness could also be a result of need of further study, inevitable reduction in the work force, or undesirability of the plan and fear of implementation. However, as shown by the financial scenarios offered by the consultants, postponing does not solve the problem, but rather makes things worse. It also makes the solutions valid at the time of the study invalid due to the change in circumstances. Privatization could only be feasible if restructuring and privatization options recommended by professionals are implemented promptly.

In the case of a loss making company, if the restructuring option was chosen by the decision-maker the sooner the action plan starts the better. If liquidation was thought to be more appropriate, it would stop increasing losses. Further, if the privatization option was selected, measures could be taken to encourage officials to pursue the recommended plan. Examples are maintaining transparency, competition and equal opportunity among all potential buyers, to reach the best deal. This would facilitate implementation and increase the willingness of officials to pursue the proposed plans with less fear of being blamed for any problems in the future. Delay in implementing any of the appropriate options in a loss making company would only mean a continuity of the losses incurred, which would negatively affect implementation of the privatization programme.

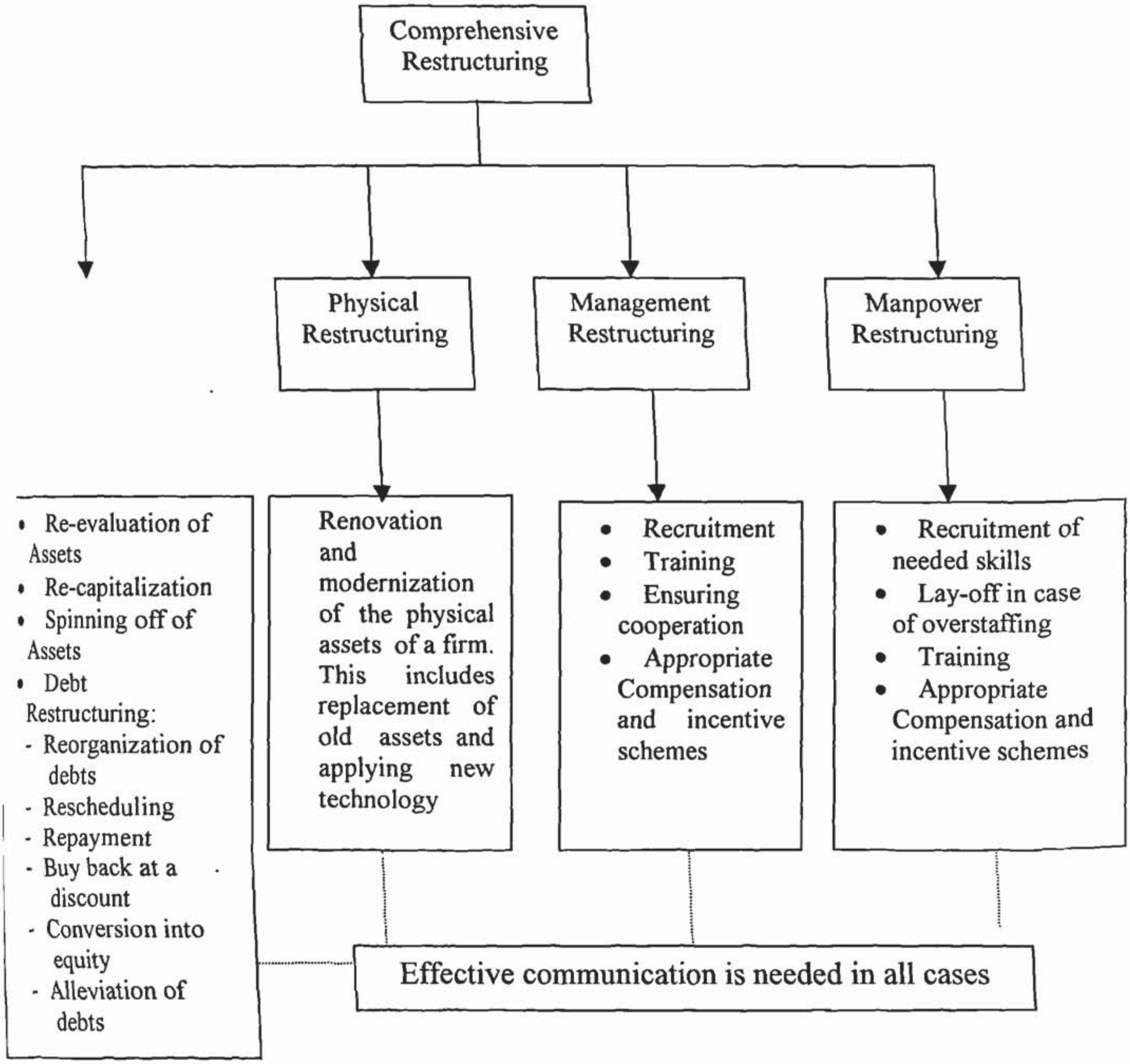
Finally, the case shows that reasons for the delay of restructuring plans are in many cases unclear. According to the model presented in Chapter Three, implementation of the different plans ought to be monitored and reasons for delay studied and overcome. If it were found that further studies are needed, they should be operated as quickly as possible or else the costs of the previous studies would be wasted. Costs of implementing restructuring should then be compared to the expected benefits in order to reach a final decision and start an action plan.

## 7.10 Conclusion

### ❖ General

- Restructuring procedures have been summarized in the following figure:

**Figure 7.1: A Summary of Restructuring Procedures**



- Several factors external and internal to the enterprise should interact for restructuring to be successful. Among external factors are the willingness and ability of governments to impose hard budget constraints on loss-making banks and enterprises to promote the larger objectives of macroeconomic stabilization, fiscal balance and economic growth. Among internal factors is the extent to which an SOE could apply "corporatization" attributes. Integration between internal and external measures is the major key to reform success.
- Although the details vary from one country to another, the reform of the institutional framework usually involves:
  - Setting well–defined goals for SOEs, which can be transformed into measurable and manageable targets.
  - Giving managers the freedom (sufficient autonomy) to act and hence to be answerable for results achieved.
  - Selecting efficient people to run the commercial venture and paying them well.
  - Managers are held responsible for results achieved including rewards and sanctions.

**❖ The Egyptian Case**

- Although the Egyptian Restructuring Programme deals with many aspects of restructuring, it lacks a comprehensive approach or an integrated plan.
- The comparison between the most common aims in successful enterprise reform programmes (Shirley, 1989) to the Egyptian Restructuring Programme (ERP) shows that:
  - The EERP has tackled many economic reform aspects necessary for successful restructuring.
  - A number of elements have not been sufficiently addressed by the ERP, namely:
    - Eliminating direct and indirect subsidies to SOEs.
    - Reduction of the number of layers in decision making especially in valuation and selling related decisions.

- Many of the social functions of the enterprise have not been completely transferred to central Government Authorities (especially in labour-related and pricing issues).
- The necessary social safety net for employees of SOEs who might lose their jobs is not completely developed.

- Aggregate figures concerning financial results of SOEs show continuation and increase of losses in many SOEs in spite of implementation of the ERP for six years.
- The CAAA (Central Authority for Accounting and Auditing) has identified the most common problems in low performing SOEs. These common problems are not sufficiently addressed in the ERP. At the same time there is no evident link between the CAAA and the structure in charge of privatization or restructuring.
- The GOE's structuring policy as expressed in the Minister of Public Enterprise's address to the Parliament seems to be in favour of assigning the restructuring task to the Government itself, to refuse liquidation of loss-making SOEs, to defend the social obligations of SOEs. The programme, as implicit in the minister's address, does not address important problems as accumulating inventories and shortage of able staff.
- One can safely conclude that most of the problems faced by SOEs are not sufficiently addressed in the ERP.

### ❖ Managers' Views

- Most managers have agreed that the internal control systems, external monitoring from Central Auditing Agency and internal incentive systems applied in SOE were either completely ineffective or needed restructuring. On the other hand they have been neutral about the management structure, the staffing methods and the pricing system used.
- Most senior managers expected that the new privatization policy and the reform efforts would help reform the financial status of SOEs.
- A considerable number of managers feel that the equality of treatment especially in financial aspects is against the interest of public sector companies.

- Managers have proposed many different ways to deal with past debts. The most frequent method mentioned in the senior managers' responses was "*increasing capital by selling stock to the public and using the money to pay off debts*".

### ❖ Findings of Case Study Analysis

The main objective of the case study included in this chapter was to demonstrate how the restructuring of SOEs takes place practically and to assess the problems encountered in the restructuring process in a real life situation. It was found out that the analyses were carried out by professionals and the resulting restructuring plan was comprehensive. Several restructuring options were prepared together with action plans needed for implementation. Yet in application the decision was delayed; slowness of decision making is a characteristic of the Egyptian privatization programme. Delay in implementation resulted in a continuation of losses unnecessarily. Reasons for delay in implementation are often unclear and at different levels, which makes things more difficult for the success of the programme.

# Chapter Eight

# Labour Issues and Privatization

## 8.1 Introduction

This chapter deals with one of the most sensitive problems accompanying privatization, i.e. the problem of redundant labour in PEs[1]. Fear of raising unemployment levels and political consequences of doing so can slow down reform. This chapter investigates whether this is the case. It discusses the origins of the problem, its size, how it affects and is affected by privatization, how the Government intends to face the problem and the methods that could be used. Managers' attitudes about the problem and the different compensation packages offered are presented. The chapter is concluded by a case study demonstrating and analyzing labour restructuring problems in a real life situation. On all aspects the researcher's assessment and comments are presented.

## 8.2 Problem Origin

The problem of redundant labour could be attributed mainly to the State policy in the 1960s and 1970s when, in an effort to fight unemployment and extend social safety, the Government offered lifetime guaranteed public sector/enterprise employment for every intermediate, or higher degree graduate. This was coupled with a free education system from the pre-school level to the highest post-graduate levels. Employment offices were established all over the country and immediately recruited any high school or university graduate in the public sector regardless of work needs or the graduate's specialization. The main objective of the Government policy was to create a new society that does not know illiteracy or unemployment.

Another reason for the increase in seekers of jobs in the public sector was the increasing immigration trend from rural to urban areas, mainly due to immense

[1]Svejnar and Terrell define redundant labour as labour whose marginal product falls short of the shadow wage rate. Operationally this is explained as workers in each skill group whose marginal productivity in the firm is lower than elsewhere in the economy (Svejnar et al, 1991).

population pressure on land (the ratio of population pressure increased dramatically from 596 persons per hectare in 1961 to 821 persons per hectare in 1990). Other social and cultural reasons also accelerated the trend. During the period 1973-84 the share of employment in agriculture declined from 59.5% to 36.5% with an absolute decline in agricultural employment of more than 11% (Karshenas, 1994). This increase in labour force transferring from the agricultural sector to the industrial sector resulted in the transfer of disguised unemployment from the village to the city (Aly, 1994). This is also shown in table 8.1.

**Table 8.1: Unemployment by Gender and Rural/ Urban Location**

*(thousands)*

| | 1960 (PC) | | | | | | 1991 (LFSS) | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Male | | Female | | Grand Total | | Male | | Female | | Grand Total | |
| | Total | % | Total | % | Total | % | Total | % | Total | % | Total | % |
| Urban | 93 | 66.9 | 26 | 72.2 | 119 | 68 | 355 | 50.4 | 413 | 52.7 | 767 | 51.6 |
| Rural | 46 | 33.1 | 10 | 27.8 | 56 | 32 | 349 | 49.6 | 370 | 47.3 | 719 | 48.4 |
| Total | 139 | 79.4 | 36 | 20.6 | 175 | 100 | 704 | 47.4 | 783 | 52.7 | 1486 | 100 |

*Source: 1960 P. C. Table 5, December 1991 LFSS Table 5 (compiled by researcher)*

The annual growth rate in the non-agriculture sector labour force was more than 4.7% during the period 1973-1984. During the oil-boom period and up to the early Eighties the growth in non-agriculture employment and the increasing demand in Gulf labour markets absorbed this large increase in labour, without aggravating the unemployment problem. The construction and manufacturing sectors equally absorbed 15% of the new additions to the labour force, while the service sector absorbed around 53% of which the major contribution was Government employment. The total public sector contribution to labour absorption was approximately 71% of which 16% were attributed to SOEs and manufacturing sector. The formal private sector labour absorption capacity did not exceed 4% in that period (Aly, 1994).

However, the growing population, the decline in oil prices and hence the reduction of the Arab demand for Egyptian labour, the immigration trend from rural to urban areas and the GOE employment policy soon raised the number of job seekers to unmanageable levels. The free schools and universities were an annual supplier of semi and fully educated graduates seeking Government employment. The public sector and SOEs were obliged to absorb the increase in the labour force for social and political reasons. Graduates would wait for up to five years until summoned by Government employment offices for jobs. Fear of rising unemployment forced the Government to employ labour in excess of its needs giving rise to a problem of redundant labour.

The Government employment policy resulted in three groups of employees (El-Boraie, 1996):

- Employees in jobs that do not consume their full time or effort (e.g. In construction, tourism and agriculture sectors which are characterized by a low number of working hours and low wage rates) and who seek second jobs to raise their living standards.
- Employees in jobs that consume their full time but do not need their education level or technical skills. This problem was a direct result of the inability to create new jobs, low mobility between jobs and minimal information about actual work needs. The problem was started by the Government that necessitated intermediate or higher level certificates for employment and was later supported by the private sector which also started to exaggerate in the education level demanded to fill in jobs like secretarial work, nursing.... etc. Most of these job holders are also under-paid.
- Another group of employees in jobs that are appropriate for their education level and technical skills and available time, but which have a comparatively low pay structure due to inefficient management, low production, high depreciation rates and low productivity. This group also usually seeks second jobs, at the expense of their resting hours.

As evident, the three groups are unsatisfied by their jobs, underpaid and seek second jobs[2] to raise their living standards, especially after their real wages have been eroded due to price increases (25% between 1980 and 1989 in manufacturing sector) (Integrated Development Consultants (IDC), 1993). The rate of decline in Government sector real wages has accelerated since 1982. By 1987 real wages declined to almost half their 1973 level. Even after the mid-Eighties, a recent study mentions that in spite of the consecutive salary raises (see Box 8.1) made by the GOE, the PE employees earnings remain lower than the international poverty line (Abdel Hady, 1997).

However, the low wages did not reduce the demand for government jobs. The lifetime security offered by such employment coupled with the undemanding work

[2]A recent World Bank Report estimates that 1 out of each 5 Government employees holds a second job ( Poverty Alleviation and Adjustment in Egypt, 1992)

conditions remain to be very attractive for many job seekers in the Egyptian society (IDC,1993). Also many of the graduates were forced to wait for government jobs because they had no other alternative. Yet the low wages gave rise to a demoralized and inefficient service (Assaad, 1989). An attitude of "give them work equal to what they pay" started being the common approach. This aggravated the problem of redundant labour.

**Box 8.1**
**Special Allowances Added to the**
**Basic Salary of PE Employees**

20% of the basic salary earned in 1987
15% of the basic salary earned in 1988
15% of the basic salary earned in 1989
15% of the basic salary earned in 1990
15% of the basic salary earned in 1991
10% of the basic salary earned in 1992
10% of the basic salary earned in 1993
In sum the PE employees' salaries were increased by 75% of their basic salaries by 1996. These raises were in the form of special allowances at first but were folded in the basic salary afterwards.

*Source: Integrated Development Consultants IDC, Labour Policy Issues in Privatization, Final Report to Betchel/PID, November 1993.*

However, low as they are on the individual level, these wages were very expensive for the Government. The Government was forced to employ labour exceeding real needs, which decreased both production and productivity. For jobs that needed only one person to perform, it was very common to recruit 10 persons or more that later appeared on the payroll. The monthly wages paid for these excess employees represented concealed subsidies for non-producing hands. These salaries ate up project resources and utilized investment money that could have been otherwise used in expansion and renovations of existing projects or even building new projects and creating new real jobs (El Boraie, 1996).

This expensive policy was gradually abandoned starting in the early Eighties. The decline of the Government financial resources forced the Government to slow down such recruitment and to eventually stop it. At first the Government imposed one year of social services (for a monthly salary of L.E 4) on all graduates. Nevertheless, lists of school and university graduates waiting for the guaranteed jobs mounted to thousands. The Government was forced to slow down employment more openly and graduates had to wait for years (sometimes reaching ten years) for their turn in recruitment[3]. Concealed unemployment was brought to the open.

The rate of open unemployment according to the 1986 Population Census was 14.7% of the labour force. This number was almost double the 7.7% recorded in 1976. Estimates of unemployment based on the Labour Force Sample Surveys indicate a rising trend since 1980s (Khawaga, 1993). According to estimates by Fregancy inclusive of long-term 'discouraged' unemployed, the rate of unemployment was close to 17.5% in 1992 (Fregancy, 1993). The high unemployment made the problem of reducing public sector employment as a consequence of restructuring and privatization politically highly sensitive.

## 8.3 The Legal Context

The existing Labour Law (137 of 1981) makes it impossible for an employer, whether public or private, to adjust his enterprise's work force according to the changing needs of the market. Lengthy procedures involving highest level of ministerial involvement [high-level inter-ministerial committee (Lay Off Committee) at the Deputy-Minister level] are required. The decision also has to be approved by the Minister of Manpower and Training (Assaad, 1996). This makes downsizing the labour force virtually impossible.

An employer will be subject to incrimination if the size of the labour force is changed without the approval of the Lay Off Committee. Only on grounds of force majeure is temporary stoppage allowed, in which case employees are still paid half their salaries. If a court decides liquidation in case of total bankruptcy, employees could be discharged but have to be paid unpredictable compensation that is determined on a case-by-case basis and that carries a first degree claim (IDC, 1993).

Although changes in the present law are being studied, the intended changes regarding job security and layoffs have a limited, direct relevance to the restructuring programme of PEs. This is mainly because the new law will be only applied on new contracts, while previous contracts continue to be governed by the Law 137/1981.

[3]The last graduates that were summoned for employment were those of 1989.

Before Law 203/1991, SOE employees were governed by Law 47/78, managing every aspect of the labour-management relationship. This law was composed of a group of comprehensive, labour biased, rigid rules circling around an eight level salary system. Law 203/1991 exempted workers in PEs from pursuing this law. However this exemption was suspended until the introduction of new regulations. Right now, managers do not know what the new law will add or whether it would be more flexible. They have to either ignore the exemption or postpone any long-term decision concerning labour.

## 8.4 Size of the Redundant Labour Problem

Most analysts and Government officials blame redundant labour on the deteriorating performance of Public Enterprises (PEs) in Egypt. Redundant labour is a major obstacle hindering the privatization process. In order to develop schemes to reduce such labour, precise information about the size of the problem should first be sought and studied.

It is very difficult to determine the extent of labour redundancy in an enterprise (Svejnar et al, 1991) since it involves comparison of what is with what should be. A common approach that has been used in many cases is the "technical or engineering approach". This approach compares average measures such as output-labour, capital-labour, or labour-cost to total-cost ratios to experts' estimation of optimal targets (Fiszbein, 1996). Unfortunately, this approach is very hard to apply on a national level.

In fact, there is no precise method by which the size, specialization or distribution of redundant labour in PE companies can be ascertained. While the Egyptian Government has calculated that the size of redundant labour is around 18%, it has publicly acknowledged that potential investors may estimate the rate of overstaffing to be as high as 40% (Moore, 1998). An estimate of 30% of total workforce in (PEs) has also been mentioned in several studies[4]. These numbers, though not necessarily accurate, could be used as indicators of the size of the problem (see table 8.2).

[4]See IDC., 1993, El-Khawaga,1993 and Assaad, 1996.

**Table 8.2: Redundancy in the Affiliated Companies***

| Date | Total Number of Employees | 18%** | 30%** | 40%** |
|---|---|---|---|---|
| 30/6/93 | 1 038 351 | 186 903 | 311 505 | 415 340 |
| 30/6/94 | 1 005 331 | 180 960 | 301 599 | 402 132 |
| 30/6/95 | 948 876 | 170 798 | 284 663 | 379 550 |
| 30/6/97 | 908 000 | 163 440 | 272 400 | 363 200 |

* *Source: Public Enterprise Office.*

** *Calculated by researcher, presumably redundant labour according to GOE, studies and the private sector consecutively.*

One approach to determine national redundancy levels in PEs would be to study redundant labour in each department in each individual company separately and then add up the results. A proposed work plan for doing so could be:

1. Prepare a workforce profile for each PE clarifying number of employees, specialization, qualifications, experience, job description and payroll in each department.
2. Ask managers of each department to prepare department plans derived from each company's business plan and optimum work schedules based on workers' job descriptions and industry level performance. Adequate numbers of employees should then be determined. The manager should then communicate the department plan to his subordinates.
3. Managers are to prepare empty schedules for each employee to fill in what he has actually done. This could be simplified by making workers fill in size of output or tick in front of certain tasks. These schedules could be filled on a daily basis and monitored on a weekly or monthly basis.
4. Actual department output can be compared to department plan. Actual worker output can be compared to pre-estimated levels of performance in the work schedules based on job description and industry level performance.
5. If actual department production is equal to or more than business plan, but individual performance is less than standard a problem exists.
6. The difference between the pre-estimated adequate number of employees and the actual size represents redundant labour. By reviewing each worker's actual performance and comparing it to standard, the problem is clarified to both the managers and the employees. There could be certain specializations or experience

levels in which there is actually a shortage while in other specializations there is a redundancy.

7. A redundant labour profile for each department could then be prepared containing number of employees, their specialization, qualifications, experience, job description and payroll. By adding up the results, totals can be estimated and a redundant labour profile can be prepared for each company.
8. Aggregate totals on the national level can be determined by adding up the results from each company profile.
9. Costs of keeping redundant labour could be estimated by using the data derived in the previous steps whether on the department, company or national level.
10. Average cost of facing redundancy through the different schemes can be determined by multiplying average costs of alternative schemes by numbers of redundant labour. Comparisons could then be made between different action plans.

## 8.5 Characteristics of the Redundant and Unemployed Labour

A recent study (IDC, 1993) summarizes characteristics of the PE labour profile in the 1990s by four important aspects:

- Concentration in the age bracket 30-49 years (since new recruitment was terminated ten years ago).
- Low educational attainment.
- Low wages.
- High levels of redundancy.

Although it is hard to accurately determine characteristics of the redundant labour, it would be rather indicative to study the nature and characteristics of the unemployed.

Starting from the mid-Eighties unemployment has been largely concentrated amongst the youth with intermediate and university degrees and with no prior job experience. According to the 1986 Population Census reported in Handousa (1991) more than 76% of the unemployed consisted of new entrants to the labour market of which 90% were highly educated eligible for the Government's guaranteed employment scheme. About 75% of the unemployed were under 25 years (19% are 15 to 20 years old, 56% are between the ages of 20 and 24 years). Only 24% of the unemployed held previous jobs, 96% of whom were male. More than 50% of this group were illiterate and 22% without an elementary school certificate. Rural unemployment rate, though initially lower than the urban rate, has been growing much faster than the latter. The gap between the two was closed in 1992 (Fregancy, 1993).

Female unemployment rate at 24.2% was more than double the male unemployment rate, which was 10.4%. Most of the unemployed females were rural, intermediate diploma holders (50%) and rural university degree holders (43%). Female university graduates from urban areas represented 30%, while urban diploma holders represented 25% of the unemployed. Male unemployment is also highest for the same categories of education. Male intermediate diploma holders represented 38%, while university graduates represented 35% of the unemployed in rural areas. In urban areas the rate was 21% for both graduates of intermediate schools and universities. The same study demonstrated that the number of unemployed among university and intermediate degree holders has increased from 145000 to 1023000 in the period from 1976 to 1986 with an annual rate of increase of 22% (N.B. These figures were accompanied with a growth rate of 3.7% in Government employment and 2.3% in public sector employment) (Handousa, 1991).

The same trend continued in 1991 (see table 8.3). Most of the unemployed continued to be intermediate certificate holders. The illiterate also accounted for a large percentage especially among males. University graduates accounted for 17.3% of the unemployed of which a large number were newly unemployed with no previous experience.

**Table 8.3: Unemployed Structure by Gender and Educational Status (percentages)**

| | Unemployed with previous Experience | | | Newly Unemployed | | | Total Unemployment | | |
|---|---|---|---|---|---|---|---|---|---|
| | Male | Female | Total | Male | Female | Total | Male | Female | Total |
| Illiterates | 73.7 | 41.6 | 72.6 | 6.8 | 1.1 | 5.1 | 26.8 | 2.5 | 21.0 |
| Intermediate | 16.9 | 49.9 | 18.0 | 73.3 | 79.6 | 75.2 | 56.4 | 78.6 | 61.6 |
| University & above | 9.4 | 8.3 | 9.4 | 19.9 | 19.3 | 19.7 | 16.8 | 19.0 | 17.3 |

*Source: December 1991 LFSS Table 18.*

The same phenomenon was noticed in Behira Governorate, a rural area[5] (El-Tabaakh, 1997). There, it was found that the total number of unemployed higher and intermediate degree holders for the period from 1983 to 1993 was 92737 from which 6557 were university graduates and 86180 were intermediate certificate holders.

According to the "1997 Year Book of Labour Statistics" (International Labour Office (ILO), 1997) the same increasing unemployment[6] trend has continued through the Nineties. The general level of unemployment[7] increased from a total of 1107900 in 1989 to 1346400, 1463400, 1415700, 1800600, 1877400 and 1916900 in the years 1989, 1990, 1991, 1992, 1993, 1994 and 1995 respectively. This represented unemployment rates of 10.7%, 17.9%, 21.3%, 17%, 22.3%, 22.8% and 24.1% from total work force for the same years.

Distribution of the unemployed for the period 1989 to 1995 according to gender and among the different age groups is shown in table 8.4. The table shows that the highest rate of unemployment whether for men or women has been concentrated in the age brackets of 20-25 years old which is the average graduating age. The second highest figure is in the age bracket 25-29 years[8] group, which reflects the accumulating unemployment caused by stopping the public sector employment in the last decade. Unemployment is also quite high for the age group between 15 and 19 years, which makes one forecast that the problem will persist in the future. Unemployment rates gradually decrease with increase in age reflecting how the problem was previously absorbed but unfortunately causing redundant labour in many cases.

[5]Most of the figures were derived from a project performed by the Ministry of Labour and Management Development together with the Ministry of State and Localities aiming to determine the size of the unemployed in Behira Governorate.

[6]Unemployed is defined in the "1997 Labour Statistics Yearbook" as comprising all persons above a specified age who during the reference period were without work, currently available for work and who are seeking work.

[7]These figures were taken in November and May of each year for the age groups of 12 to 64 years.

[8]Excepting for women in the years 1989, 90 and 91.

**Table 8.4: Total Unemployment by Gender and Age Group for the Period 1989/95**

*(thousands)*

| | . | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 |
|---|---|---|---|---|---|---|---|---|
| **Grand Total** | | | | | | | | |
| **Men** | **Total** | **623.9*** | **615.6*** | **704.0*** | **776.8**** | **956.2** | **964.6** | **998.2** |
| | 6-14 | 8.4* | 4.4* | 2.8* | 5.3** | 5.3 | 5.2 | 6.7 |
| | 15-19 | 109.6* | 111.5* | 129.8* | 99.8** | 139.4 | 136.6 | 186.3 |
| | 20-24 | 275.1* | 245.1* | 333.1* | 373.9** | 455.3 | 472.4 | 476.2 |
| | 25-29 | 173.5* | 183.1* | 185.8* | 248.2** | 285.5 | 279.7 | 263.7 |
| | 30-39 | 33.2* | 40.9* | 36.0* | 35.6** | 61.1 | 60.1 | 55.7 |
| | 40-49 | 7.9* | 10.9* | 2.2* | 4.6** | 6.1 | 6.8 | 6.6 |
| | 50-59 | 7.4* | 6.0* | 2.5* | 0.6** | 3.5 | 3.1 | 1.7 |
| | 60-64 | 1.2* | 1.7* | -* | 0.6** | - | 0.3 | 0.9 |
| | 65+ | 7.6* | 12.0* | 11.8* | 8.2** | - | 0.4 | 0.4 |
| **Women** | **Total** | **499.3*** | **752.4*** | **782.7*** | **657.8**** | **844.8** | **914.4** | **919.9** |
| | 6-14 | 5.3* | 3.4* | 2.6* | 1.2** | - | - | 0.7 |
| | 15-19 | 111.6* | 159.4* | 168.5* | 134.5** | 155.6 | 166.7 | 218.0 |
| | 20-24 | 270.7* | 339.2* | 376.9* | 359.0** | 434.5 | 471.6 | 430.9 |
| | 25-29 | 98.0* | 148.5* | 128.5* | 134.8** | 216.9 | 233.7 | 228.8 |
| | 30-39 | 8.2* | 90.1* | 100.7* | 16.1** | 37.3 | 41.0 | 40.8 |
| | 40-49 | 0.7* | 1.1* | -* | 0.8** | 0.3 | 0.5 | 0.4 |
| | 50-59 | -* | 1.3* | 1.7* | 1.0** | - | 0.3 | 0.3 |
| | 60-64 | -* | 1.4* | 1.3* | -** | - | 0.3 | - |
| | 65+ | 4.8* | 8.0* | 11.5* | 10.4** | 0.2 | 0.3 | - |

*December ** May, June, September, and December

*Source: International Labour Office (ILO), 1997 Yearbook of Labour Statistics, International Labour Organization, 1997, Geneva, p.456.*

Another significant set of figures is that related to the rate of economically active[9] population as compared to the total population, illustrated in table 8.5. The figures reflect low rates of activity between the ages of 15 to 30 which should be the most active age.

[9]Economically active is defined in the "1997 Labour Statistics Yearbook" as all persons of either sex who furnish the supply of labour for the production of goods and services during a specified period.

**Table 8.5: Economically Active Population (1995)***

| | Total | | | Men | | | Women | | |
|---|---|---|---|---|---|---|---|---|---|
| Age | Total Population | Active Population | Activity Rate % | Total Population | Active Population | Activity Rate | Total Population | Active Population | Activity Rate |
| 0-14 | 22994000 | 361 300 | 1.6 | 11712 000 | 302 400 | 2.6 | 11282000 | 589 000 | 0.5 |
| 15-19 | 6051 000 | 1541 500 | 25.5 | 3103 000 | 1168 800 | 37.7 | 2948000 | 372 700 | 12.6 |
| 20-24 | 5300 000 | 2265 300 | 42.7 | 2716 000 | 1537 500 | 56.6 | 2584000 | 727 800 | 28.2 |
| 25-29 | 4495 000 | 2370 200 | 52.7 | 2244 000 | 1723 000 | 76.8 | 2251000 | 647 200 | 28.8 |
| 30-39 | 7241 000 | 4284 000 | 59.2 | 3617 000 | 3237 600 | 89.5 | 3624000 | 1046 400 | 28.9 |
| 40-49 | 5764 000 | 3723 600 | 64.6 | 3103 000 | 3043 800 | 98.1 | 2661000 | 679 800 | 25.5 |
| 50-59 | 3896 000 | 2265 500 | 58.1 | 2005 000 | 1962 500 | 97.9 | 1891000 | 303 000 | 16.0 |
| 60-64 | 1302 000 | 518 700 | 39.8 | 620 000 | 473 600 | 76.4 | 682000 | 45 100 | 6.6 |
| 65+ | 2184 000 | 395 800 | 18.1 | 1018 000 | 371 600 | 36.5 | 1166000 | 24 200 | 2.1 |
| Total (15+) | 6051 000 | 1541 500 | 25.5 | 3103 000 | 1168 800 | 37.7 | 2948000 | 372 700 | 12.6 |
| **Total** | **59227000** | **17725 900** | **29.9** | **30138 000** | **13820800** | **45.9** | **29089000** | **3905100** | **13.4** |

* Drawn from Labour Force Sample Survey

*Source: International Labour Office ILO, 1997 Yearbook of Labour Statistics, International Labour Organization, 1997, Geneva, p.9.*

### ❖ Comments

Most of the unemployed are concentrated in the age bracket between 20 and 30 years with comparatively low economic activity rates for that age.

- Most of the unemployed are intermediate certificate holders followed by university graduates.
- In contrast to the excess in intermediate and higher level graduates, there is an evident shortage of educated skilled professionals (hourly rates of plumbers, electricians, construction workers...etc. have sharply risen within the last two decades, reflecting their scarcity). This could be explained by the preference of most parents whether in rural or urban areas to give their children a formal education aiming for a "*white collar career*" due to social reasons.
- With population growth in mind coupled with the substantial cuts in Government and public sector employment one can imagine what the size of the problem would be in ten years. The researcher agrees with most analysts that an intensive increase in job opportunities and hence investments is needed to absorb the growing workforce (see Handousa, 1991).

## 8.6 Privatization and Labour

Privatization is both affected by and affects the labour force (Gerry Johnson et al, 2000). Privatization will either result in restructuring or sale of SOEs, which will in both cases mean a reduction in the workforce and in many cases a change in management and management systems. Knowing the numbers of those unemployed and the limitations of the available social security net, one could imagine reasons for the fears of SOE personnel. To illustrate this, table 8.6 shows the PEs that lost more than 50% of their issued capital before the year 1992. The number of workers in each company is also included. If these companies are to be liquidated or divested this will put 197,903 workers out of work. It is worth mentioning that the first 16 companies were actually included in the 1992 / 93 restructuring programme (IDC, 1993).

To be easily implementable, privatization has to be desired by all the managers, employees and workers (see Galal, 1995 and Krueger, 1995). They must feel secure about their jobs and careers if they are to continue in the company and know what their options are if they choose or have to leave. Otherwise, the work force could form considerable resistance that hinders implementation of privatization. If labour unions were against privatization and were organized enough, they could represent a serious obstacle to implementation of privatization.

Fear of workforce resistance and possible social consequences of increased unemployment could also create reluctance among decision-makers in higher planning levels to act speedily. The delay could take years.

**Table 8.6: Number of Workers in the SOEs which Lost more than Half of their Capital by the Year 1992**

| | | Total Assets in L.E 1000 | No. of Labour Force |
|---|---|---|---|
| 1 | Misr Helwan Spinning & Weaving Co. | 309 966 | 12 963 |
| 2 | National Spinning & Weaving CO. | 165 128 | 6 041 |
| 3 | Middle Egypt Spinning & Weaving CO. | 148 845 | 6 397 |
| 4 | Nasr for Spin., Weav. & Knitting Co. | 96 160 | 4 423 |
| 5 | Cairo Silk Textiles Co. | 83 111 | 3 890 |
| 6 | Alexandria Metal Products | 85 144 | 1 947 |
| 7 | Cairo Metal Products | 65 291 | 2 951 |
| 8 | El Nasr Co. for Television & Electronics | 269 471 | 2 702 |
| 9 | Egyptian Fero Alloys | 256 166 | 2 240 |
| 10 | Alexandria Shipyard | 316 800 | 5 129 |
| 11 | General Egyptian Irrigation Workshops Co. | 53 604 | 1 935 |
| 12 | Misr Dairies & Food Co. | 149 850 | 5 433 |
| 13 | High Dam Co. for Civil Works | 58 737 | 1 412 |
| 14 | Egyp. Irrigation Drainage & Civil Construction | 38 972 | 650 |
| 15 | The Egyptian Wood Working Co. (WOODCO) | 34 459 | 34 459 |
| 16 | The General Co. for Batteries | 40 274 | 1 443 |
| 17 | Egypt. Co. for Electric Instruments(SHAHER) | 128 051 | 3 083 |
| 18 | Egyptian Co. for Chemical Trading | 80 318 | 2 058 |
| 19 | El Nile Co. for General Engineering | 61 875 | 1 275 |
| 20 | Egyptian Co. for Metallic Cons.(METALCO) | 94 432 | 3 791 |
| 21 | Erection & Industrial Services Co. | 65 408 | 1 669 |
| 22 | El Nasr Co. for Rubber Products | 63 899 | 2 060 |
| 23 | San El Hagar Agr. Co. | 61 978 | 680 |
| 24 | El Gomhoria General Contracting Co. | 79 737 | 1 360 |
| 25 | El Wady General Co. for Contracting | 57 331 | 873 |
| 26 | Prefabricated Houses Co. | 51 366 | 1 118 |
| 27 | Nile for Reinforced Concrete Co.(SPECO) | 122 693 | 3 721 |
| 28 | Arab General Co. for Foundation (VIBRO) | 55 309 | 2 142 |
| 29 | El Saeed General Co. for Contracting | 44 444 | 1 930 |
| 30 | Egyptian Contracting Co. {ELABD) | 123 243 | 2 019 |
| 31 | Red Sea General Co. for Contracting | 25 511 | 594 |
| 32 | The Canal General Co. for Contracting | 41 779 | 792 |
| 33 | El Nasr for Civil Works Co. | 61 020 | 1 831 |
| 34 | Sand Bricks Co. | 164 701 | 3 215 |
| 35 | El Nasr Hardboard Co. (FARASCOUR) | 14 954 | 448 |
| 36 | General Co. for Mineral Wealth | 147 618 | 1 766 |
| 37 | Egyptian Gypsum, Marble & Quarries Co. | 233 552 | 2 025 |
| 38 | Port Said Spin. & Weav. Co. | 60 771 | 60 771 |
| 39 | El Wady Cotton Ginning Co. | 34 627 | 1 018 |
| 40 | Arab Cotton Ginning Co. | 38 088 | 1 190 |
| 41 | Al Kahira Cotton Co. | 377 910 | 816 |
| 42 | The Cotton Trading & Export Co. | 255 394 | 842 |
| 43 | Alexandria Commercial Co. | 297 100 | 801 |
| | **Total** | **5 014 492** | **197 903** |

Source: IDC, Labour Policy Issues in Privatization, November 1993.

# 8.7 Alternative / Complementary Schemes for PE Labour Force Reduction

Several schemes to absorb redundant labour in SOEs have been adopted by the Government to deal with labour problems. A brief description of those schemes and of others that could be implemented is presented and assessed by the researcher in this section. Afterwards, managers' views on some of those schemes are solicited to assess degrees of acceptance/non-acceptance. A case study is also included to demonstrate the application of a number of those schemes in practice.

## 8.7.1 Main Constraints

Selling state-owned enterprises with the labour force intact is not a practical alternative for many organizations, especially those with huge numbers of redundant workers or difficult labour relations at the time of privatization (Rama, 1999). The sale would either be unattractive for private investors or else they would discount the sale price, leading to lower sale revenues and potential public opposition. Moreover, if the social safety nets are not sufficient, leaving large-scale downsizing to the private sector could cause many social problems. In the absence of alternative job opportunities, it could take the redundant labour years to find other jobs (Kikeri, 1998).

Legal constraints in the Egyptian labour market are another factor that has to be taken into consideration in dealing with the redundancy problem. The legal environment is biased in favour of employees. An independent consultant has recently stated in his report (IDC, 1993): "In a few countries in the world is the job security of public sector so absolute as in Egypt. This major obstacle has to be borne in mind all the time when options for laying off workers are considered."

Another constraint in the Egyptian labour market is the immobility of workforce due to Egypt's housing and rental laws. The high housing costs and the scarcity of units available for rent augment the value of an already existing accommodation preventing employees from moving freely from one locality to another.

## 8.7.2 Main Options

In this section some of the options the GOE can employ to face the problem of redundant labour are discussed. Many of these options have been proposed by different authors and analysts (e.g. IDC, 1986, El-Boraie, 1996 and Kikeri, 1998). Some of them are being studied by the GOE and a few have already been implemented. The next section investigates acceptability of these options among managers of SOEs.

### 8.7.2.1 Cash Payment for Separation

The easiest and most straightforward method is to offer cash compensation to employees for voluntary retirement. In this method a "one-shot amount" is paid for employees, to allow them to build their own small businesses or help them out until they find another job.

The Egyptian experience shows that this option has been most attractive for elder employees. When offered the choice they *would* choose voluntary retirement and accept payment to make up for the lost portions of their pensions. Many of them would start their own businesses while others would be satisfied by receiving interest on savings and try to find another job (see section 8.8 for managers' attitudes).

On the other hand younger employees usually do not have enough finance or skills to start their own businesses. The money they would receive on such a scheme would be proportional to their low wages, which would not make it tempting enough for them to retire voluntarily. Most of them would prefer a steady job with the secure income they already have. Middle-aged employees would, in most cases, have the same point of view especially because most of them would have family household responsibilities which burdens that require steady incomes with no risks.

In designing such a scheme it is essential to take into consideration age, salary level and number of service years. It is also necessary to offer retired employees temporary compensation to cover the period until they find alternative employment.

The cost of severance compensation in each company depends on the number of workers, their age groups and their wage structure. Several formulas have been developed by specialists in order to calculate fair amounts of severance payment. Among these formulas is the one mentioned below (Box 8.2). The model results in two sums: an amount provided as regular compensation for the unemployment period and another given to them at re-employment (whether new employment or self-employment), in an effort to encourage re-employment.

**Box 8.2: Cash Severance Payment**

Wu = W . P, paid for a maximum period (D).

L = W. (D-d). Z

Wu= Unemployment support payments for a duration (d)

W= The last basic Wage earned by the employee

P= The factor that determines the portion of the last gross monthly income earned by employees including basic salary plus variable amount

L= The lump sum of money granted the employee upon re-employment

D= The maximum period for which an unemployment compensation is granted

d= The duration of the employee's unemployment

Z= The factor which determines the proportionate increase in (L) for (d) period

*Source: Integrated Development Consultants, IDC, Labour Policy Issues in Privatization, Final Report to Betchel/PID, November 1993.*

R. Assaad, a human resources specialist, examined several other models (Assaad, 1996). The several options he studied were characterized by an opportunity cost approach that tries to compensate for the losses an employee incurs by voluntarily accepting a severance package. He assumed that workers would only accept a package if its value at least equals their losses by early retirement. This would be equal to the discounted value of their salary payments and value of non-wage benefits up to retirement age plus any transitional costs of job dislocation. He mentioned that estimation of the non-wage benefits was the most challenging task. Once he took care of that, he applied several formulas and compared their entire costs. The main finding of the simulation exercise was that several of the commonly used formulas that are based on years of seniority are less efficient than the simple fixed payment programmes (Assaad, 1996).

Box 8.3 shows another model that has actually been used by the GOE in the case of Alexandria Shipyard Company (see annex to Chapter 8). The model mainly depends on calculating a fixed sum proportional to basic salary and benefits. The model was developed by the Social Development Fund to encourage early retirement of workers as part of an integrated labour-restructuring scheme. Different options were introduced to the work force according to their ages after imposing appropriate caps (maximum compensation allowed) in different alternatives. The case demonstrates advantages and disadvantages of using this scheme.

**Box 8.3: Alexandria Shipyard Cash Severance Formula**

Compensation in L.E=

$$\{(\text{Present Basic Salary} + \text{Benefits}) \times \left(\frac{60 - \text{Age}}{2}\right)\} + \{\text{Basic Salary} + 40\}$$

From the above analysis the following conclusion can be drawn:

Cash severance compensation for voluntary retirement could be a very effective tool to encourage early retirement. Yet the amounts paid should compensate retired employees for the non-monetary benefits he receives as a public employee. The package should also include a temporary allowance to cover the transitional period in which he is seeking a new job.

## Government Early Retirement Scheme

The GOE reached an agreement (IBTCI, January-March, 1997) with labour unions in March 1997 for an Early Retirement Scheme (ERS) which to provide male workers, between the ages of 50 and 58, a lump-sum retirement payment of approximately LE 12,000 to LE 35,000 depending on their current salary. Female workers were eligible from ages 45 to 58. The programme was to be voluntary and to be available for a number of loss-making companies that would be announced by the Government at a later stage.

The main deficiency of this scheme is that it only addresses a special category of employees in companies to be liquidated. It does not solve the problems of younger employees in these companies or the problem of redundant labour in general. It also does not meet the needs of more highly compensated workers.

Developing the Early Retirement System is of great importance for the GOE. This would not only help solve the problem of redundant labour but would also save the GOE large amounts of money. It is worth mentioning that although some companies stopped operations, they are still paying workers. For example, General

Company for. Batteries stopped functioning in 1992 but is still paying 1100 employees. Some maintain the company is still functioning at around 5%, but for all practical purposes it has ceased to exist. If the average salary was LE 500 per each employee, the cost to the public for this company alone has reached around LE 26 million for practically no production and no work over the period 1992-1997 (IBTCI, January-March, 1997).

### 8.7.2.2 Early Retirement while Keeping Pension Rights

Pension benefits in Egypt are governed by a unified social security system that applies to both the public and private sectors. This system was designed to encourage retirement at the age of 60 which is the only case an employee receives full pension.

If the employee stays in the enterprise until the age of 60, he is entitled to his full pension calculated as a function of the last basic salary added to its variable components (special allowances, bonuses and incentives)[10]. Early retirement is allowed starting from the age of 45 provided that the employee served a minimum of 20 years in the firm, in which case he receives a reduced pension. For each year of early retirement prior to 60 years, the retired person has a reduction of 5% on the variable component of his pension. Another 5% of the pension earned on the basic salary is deducted if he retires before he is 55 years old. In other words at ages 50, 53 and 57 the pension is 60%, 40% and 15% lower respectively, than when retiring at age 60. This system undoubtedly discourages early retirement even if accompanied by severance payment (*IDC, 1993*).

To encourage early retirement the GOE should adjust the Social Security System to allow the retired person to receive his full benefits, in case of voluntary retirement. A more expensive option is to offer a compensation that offsets the anticipated benefits of retirement at the age of 60.

[10]Some PE have their own supplementary retirement benefits such as the Special Insurance Funds which also reward retirement at age 60.

#### 8.7.2.3 Offering Unwanted Company Assets at Separation

One of the schemes that proved to be very popular in Egypt was offering severance in the form of unwanted company assets instead of cash payments. This includes land, machinery, equipment, vehicles or retail outlets. Such a scheme could be very effective, especially if the assets are offered at market prices. Credit and easy payback facilities could be used to help the buyer complete the purchase.

In an actual case an Egyptian land reclamation PE being liquidated offered plots of land at below market prices, with an attractive instalment system for departing employees. The offer succeeded in arousing very strong demand and all the land the company wished to sell was sold. Unfortunately, this scheme was very costly mainly because the reclaimed land was offered for a below market price. Valued at market price the average employee received LE70000.

#### 8.7.2.4 Offering Shares through "Employee Shareholders Association (ESA)"

Employee Shareholders Associations allow employees to buy shares at reduced prices, and easy credit terms changing them from workers to owners. This option could be used as an alternative or as a complementary procedure to *cash* severance payment. This has the advantage of keeping the link between the company and the retired employee while reducing the amounts of cash that have to be paid. It also serves the privatization objective of broadening the ownership base.

The following table shows actual ESA's offerings during the period 1991 up till the end of the year 1999.

**Table 8.7: Total ESA Offerings During the Period 1991-1999***

| | 1994 | 1997 | 1998 | 1999 | Total | % of Total Privatization |
|---|---|---|---|---|---|---|
| ***ESA's*** | *10* | 5 | 11 | 4 | 30 | 27 % |

*No ESA offering took place in the years that were not mentioned in the table, namely 1991, 1992, 1993, 1995 and 1996.
*Source:* PEO, compiled by researcher

### 8.7.2.5 Subcontracting the Provision of Goods and Services to Departing Employees

This option could be used as a supplementary alternative to cash compensation especially if the nature of the PE candidate allows subcontracting of an intermediate product or service. Employees could be offered these subcontracts as part of the severance compensation thus reducing its monetary component. With a guaranteed subcontract, the retired would have an alternative career to pursue. Employees who want to start their own businesses would have a guaranteed supplier or market for their products or services. They could use their cash severance compensation in purchasing machinery, equipment or materials needed for executing the subcontract.

The privatized company could offer different kinds of assistance to encourage employees to choose this option. It could assist them in acquiring material and equipment or provide them with training courses or even with credit to support them. The company could also give previous employee subcontractors priority in execution over external subcontractors. This would increase employee income generation prospects on departure and would also maintain the company-employee relationship.

This scheme has provided incentives to attract a large number of employees who wish to start their own businesses. It is also characterized by low costs for the company. It could be used as a supplementary component that reduces the amounts paid in severance compensation. This scheme has been proposed in the case of Coca-Cola Company where redundant workers were offered soft-drink distribution subcontracts. Actual experience will show the extent of success of this scheme.

### 8.7.2.6 Offering Credit for Departing Employees to Start up Businesses

Many of the departing employees especially those with prior experience in business (perhaps in a second job), show interest in starting their own businesses. In many cases the severance compensation is not sufficient to start business. This scheme offers those with entrepreneurial skills the chance to extend their capabilities by giving them low collateral credit facilities with comparatively longer maturity dates. The scheme is especially more successful when combined with the scheme offering unwanted company assets as part of the severance compensation. Its cost could simply be estimated as a function of the default rate and the decrease in interest rates below market value (if applicable). However, international experience shows that this type of solution has proved to be very costly. In many cases previous public employees have not been very successful in business. Different governments had to withdraw schemes due to high default rates. Some of them complained that some of the employees considered the credit as part of the severance payment and had no intention to pay it back.

In Egypt, such credit has been offered as one of the " Social Fund for Development" schemes (see section 8.9 for more details). Most of the credit offered under this scheme is offered at low interest rates, 5 years maturity and at least one year grace period. The maximum loan allowed for an already established business is L.E 10,000 while it goes up to L.E 50,000 for a new one, with the possibility of increasing it to L.E 200;000 if the new business has four partners. An annual exhibition gathering all participants is held to help the beneficiaries of this programme in marketing their products.

### 8.7.2.7 Training and Retraining

Training redundant labour for new employment or self- employment has been an attractive option in many privatization programmes. To plan such a scheme a demand driven approach should be adopted in order to prepare training programmes for the most needed skills. Such programmes would be even more effective if planned in coordination with prospective employers.

Retraining could be used to teach redundant employees new skills or to upgrade their present performance to make them more useful for the company. This is especially important in cases of restructuring companies or preparing them for sale (see section 8.10 for case study).

In Egypt, the main constraint in applying this scheme is the scarcity of training suppliers who are sufficiently geared to labour market needs. Training services are still dominated by state-owned institutes, schools or universities that are characterized by low resources and isolation from real market needs, raising doubts about effectiveness.

Another employers' concern when investing in training (usually when restructuring is involved) in order to improve employee performance or retrain existing work force to gain new skills adequate for the company, is that there is no guarantee that the trainees would remain in the company after the training is completed.

### 8.7.2.8 Encouraging Labour to Undertake Long-term Unpaid Holidays

This scheme aims to encourage labour to undertake long term unpaid holidays. This could be utilized by workers to try alternative employment or to start their own businesses. This could encourage some workers to seek alternative employment and overcome the fear of leaving a secure Government job. Once a new job has been found, whether self-employment or employment in the private sector, the employee or worker has to resign from his / her Government job (it is forbidden by law to have any other job with the government job).

Although this could be a valuable option to many, there is fear that the employees get employed in the new jobs and continue in their old ones without resigning to get their promotions and pension rights (many women do that in the form of maternity leave extending six years). This could be avoided by more strict application of the law.

### 8.7.2.9 Help in Finding Alternative Employment

This method is targeted at the younger employees who need to find another job. Its aim is to find new employment for redundant labour. To be effective such a system needs to have full information about employers' needs and employees' capabilities for effective matching. Real job opportunities also have to be developed. Right now, the Social Fund for Development is the main provider offering job placement services (see section 8.8), but its services are still rather limited.

Local Labour Offices affiliated to the Ministry of Labour performed this job during the last three decades. They could be made more effective in matching job seekers to real opportunities. An alternative method of implementing this scheme is encouraging private sector recruitment agencies to offer job consulting and placement services.

A major constraint on this scheme is the limited number of available vacancies in the job market. Previously, the public sector was capable of absorbing the increasing work force. Now after the structural adjustments and the reform procedures, this is no longer the case. This again underlines the importance of creating more real jobs in the job market.

### 8.7.2.10 Linking Incentives and Bonuses to Real Productivity

This method entails linking incentives and bonuses to real performance. This would include:

- stopping incentives and profits distributed in loss making companies;
- stopping nation-wide bonus schemes;
- canceling promotion by seniority and linking promotion to performance;
- insisting on more demanding work conditions while increasing accountability and punishing inefficient employees, and
- forbidding second jobs more seriously ( legally, second jobs are forbidden for government employees, but practically most employees have second jobs due to low wages).

These measures would change the attitudes of most employees towards public enterprise jobs. It would no longer be "a monthly salary with negligible work" to which they usually add a second job. Those pursuing salaries and financial benefits without work will definitely choose early retirement.

### 8.7.2.11 Developing Existing Legal Framework

The current system biased in favour of employees makes any of the above schemes voluntary depending on the reaction of employees, which is in its turn dependent on many other social and cultural aspects. This system should be altered to make it more suitable to a more liberalized, market-oriented economy.

In 1994, the International Labour Organization initiated an effort to modernize the present legal framework to a more supportive system to Egypt's present transition to a market economy. The new law, which is still under development, will legalize dismissal of workers on economic grounds, for the first time. It would also provide them with the right to strike, which, as seen by some of the labour representatives would counterbalance the effects of dismissal on economic grounds. In addition, it would change some of the rules related to women's employment such as reducing the length of unpaid maternity leave from six years to two and elimination of the prohibition of night time employment for women (Al-Ahram, 17th January, 1997).

Although the new permission to dismiss on economic grounds was welcomed by most parties the Government and the business community were rather resistant to legalizing the right to strike. Strong resistance is also expected in the People's Assembly (the Egyptian Parliament) concerning the proposed developments of the labour law affecting women (IBTCI, January-June, 1997).

#### 8.7.2.12 Simple Attrition through Retirement

This alternative is an easy, though slow, option. It simply involves stopping new recruitment in PEs and waiting until the existing workforce eventually retires. Although this option seems attractive since it would rouse the least resistance by employees, it has several major deficiencies. Firstly, it would increase the average age of employees, while many jobs need younger workers to perform. It would also deprive the firm of injecting new blood with new ideas and fresh enthusiasm to develop work in the firm. This option will also take a long time to reach the adequate size of the workforce, which might not be the optimal distribution of specializations needed by the company.

#### 8.7.2.13 Establishing a Centralized Authority for Solving Problems of Redundant Labour

Another scheme that has been suggested by some analysts (El-Boraie, 1996) is establishing a centralized authority including concerned departments from the Social Insurance Organization, the Training Department in the Ministry of Labour and some representatives of the private sector. The main task of this authority would be to estimate the size of the redundant labour, their distribution and specialization, to design and implement training, to distribute severance payments and to support the retired employees by different methods.

Although this solution deserves further research, it is doubtful, in view of the labour situation from a broad national perspective, that it will lead to successful results.

The problem of redundant labour within Law 203/1991 companies will have to be addressed company by company as they are liquidated or sold. It should be recalled that under the socialist system, it was precisely the idea that it was the responsibility of Government to find employment for everyone and that full employment could be planned on a national basis, which led to the current situation. With the economic policies in place at the time, those who could not find employment were placed inside public sector companies whether they were needed or not.

### 8.7.3 Comments on the Different Schemes

Combining several of these options could create attractive packages that increase prospects for retiring employees encouraging them to choose voluntary retirement. Success in implementing them would increase feasibility of implementing privatization by minimizing possible resistance and credibility of the Government by actually offering what it promised. The fact that most of these schemes are optional is also very important since it would leave managers and employees with attractive options to choose from without pressure, which decreases resistance to minimal levels.

However, most of these compensation packages and schemes are planned and sometimes implemented for managers, employees and technical workforce in the same company, alike, depending on the length of experience. This neglects the fact that adequacy of these packages to different workforce categories might be quite different. This is why the researcher has found it adequate to solicit top and middle managers' views about the different schemes with the objective of identifying the extent of acceptance among them.

It is also the researcher's view that the problem of unemployment and redundant labour will not be solved radically except by the growth of the economy as a whole and the increase in real job opportunities. These plans could be effective as tranquilizers in the short run but increasing investments in projects with labour intensity is the only option to absorb the continuously growing labour force.

'The Alexandria Shipyard case study (section 8.10) to demonstrate how the different schemes have actually been applied. It also shows the role of the Social Fund for Development (discussed in the following section) in facing the problems of redundant labour.

## 8.8 The Social Fund for Development

The Social Fund for Development (SFD) was established in 1991 by Presidential Decree No. 40 with the objective of minimizing the adverse effects of the Economic Reform and Structural Adjustment Programme (ERSAP) on low income groups (SFD, 1996). This was to be done by creating jobs, helping with the problems of redundant labour from the privatization programme, and dealing with the side effects of the reform programme in general (see section 8.10 for a practical case illustrating the Fund's role in labour adjustment).

The main target groups to be served by the fund are (SFD,1996):

- the unemployed youth;
- new graduates;
- public enterprise workers who may be displaced as a result of public enterprise restructuring;
- women, and
- inhabitants of areas deprived of basic services.

The SFD works through a network of 16 regional offices under the direct supervision of the Prime Minister. The Board of Directors defines the SFD's overall policies and strategies, and determines the priority of activities. Disbursements of resources are made according to agreements with fund donors. Different projects are then monitored and evaluated regularly by SFD.

The SFD carries out its projects through sponsoring agencies, which may be Ministries, public or private sector enterprises, non-governmental organizations (NGOs), private voluntary organizations (PVOs), Governorate Administrations, financial institutions, and local community agencies. The resources are in the form of loans and grants, contributed by the Government of Egypt, the World Bank/IDA, the European Union, Arab Funds and other multilateral and bilateral donors. Loans are directed towards productive activities. Grants are used to finance infrastructure development projects in rural communities and urban poverty zones. Until April 1996 total resources of the SFD had reached the amount of US$ 744.40 million, consisting of US$ 319.36 million in loans and US$ 425.04 million in grants.

The objectives of the SFD (SFD, 1996) are achieved primarily by promoting income and employment generation activities, and availing basic social services and awareness. This is done through five core programmes and an independent unit:

- The Public Works Programme aiming to provide and improve essential infrastructure in low-income areas. It also aims to generate temporary employment for skilled and unskilled labour and create long term employment through operation and maintenance activities.
- The Community Development Programme aiming to mobilize local community in productive/income generating activities and social development activities. It also aims to enhance women's participation in socio-economic development. The Population Activities Programme (sub-programme affiliate of the Community Development Programme) aims at the reduction of the rapidly increasing population.
- The Enterprise Development Programme's main objective is to promote employment and income generating opportunities in the small enterprise sector, by encouraging new businesses and the expansion of existing activities. Providing small businesses and potential entrepreneurs with credit, technical assistance, training and know-how are the main approaches.
- The Employment and Retraining Programme is mainly targeted at PE workers and new graduates. Its main mission is to respond to the needs of public sector employees during and immediately following the restructuring of the firms that employ them. It is mainly in charge of providing early retirement benefits, separation funds, training/retraining, unemployment insurance, professional consulting, job placement and seed money for starting businesses. It also aims to develop programmes that create jobs for new graduates.
- The Institutional Development Programme aims to enhance the Government's capacity to monitor the impact of its economic policies on living conditions. It also provides support for the Government and SFD.
- The Gender Unit as an independent unit that aims to gear the SFD's development role while encouraging women's participation

These programmes are to address the immediate and urgent needs of the target groups. At a later stage, they are to reinforce the Government's capacity to draw up and monitor poverty alleviation policies, and to promote its institutional capacity to develop new social programmes and/or modify existing ones.

The initial objective of the SFD was to help with the problems of redundant labour from the privatization programme. However, it has been noticed that the current composition and focus of programmes within SFD are not primarily directed at solving redundant labour problems. The necessity for the SFD to begin operations before the privatization programme really gathered momentum resulted in initiating a number of programmes, which may not have been strictly focused on labour issues related to privatization. It might be useful to examine some of the programmes currently operated by the SFD to see if they can be effectively focused on privatization-related labour issues.

## 8.9 Managers' Attitudes towards Different Labour Issues

Attitudes of managers concerning present labour issues and proposed labour schemes are discussed in this section, since some of the employee compensation schemes directly affect managers.

### 8.9.1 Managers' Opinions Regarding Whether Labour Resistance is an Important Obstacle to Privatization (Q.11)[11]

Managers' opinions towards the most important obstacles facing privatization have been solicited. Labour resistance to privatization was one of these items. As shown in table 8.8, the majority of managers feel that worker resistance is among the most important obstacles hindering the implementation of privatization. It is safe to say that most of the resistance would probably be out of fear of accompanying job losses.

[11] Also mentioned in Chapter 5 in section 5.8.1

**Table 8.8: Managers' Opinions Regarding Whether Labour Resistance is an Important Obstacle to Privatization**

| Responses → / Managers' Classification ↓ | | Very important | Import-ant | Neutral | Un-important | Not at all important | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|
| All Managers | | 32.5 | 24.2 | 21.6 | 13.9 | 7.7 | 100 | 35.9*** | |
| Management Level | S.M | 29.5 | 22.7 | 27.3 | 15.9 | 4.5 | 100 | 27.6*** | 5.501 D.F=4 NS |
| | M.M | 34.9 | 25.5 | 17.0 | 12.3 | 10.4 | 100 | 22.0*** | |
| Type of Business | Indust. | 36.4 | 14.5 | 20.0 | 20.0 | 9.1 | 100 | 11.46* | 5.447 D.F= NS |
| | Non Indus. | 32.8 | 29.5 | 18.9 | 12.3 | 6.6 | 100 | 30.21*** | |
| Senior Mgmt. Only | Indust. | 50.0 | 0.0 | 21.4 | 21.4 | 7.1 | 100 | 11.29* | 7.105 D.F=4 NS |
| | Non Indust. | 28.1 | 29.8 | 22.8 | 17.5 | 1.8 | 100 | 14.19** | |
| Middle Mgmt. Only | Indust. | 31.7 | 19.5 | 19.5 | 19.5 | 9.8 | 100 | 4.98NS. | 4.269 D.F=4 NS |
| | Non Indust. | 36.9 | 29.2 | 15.4 | 7.7 | 10.8 | 100 | 20.46*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The Chi-square tests show that while statistical differences in distribution within the same groups are quite different from what would be expected on a chance basis, differences among the different groups are statistically insignificant.

## 8.9.2 Managers' Views Concerning Adequacy of Staff Size (Quest. B-Q23)

Manager's were asked whether the size of the work force in the respondents' companies was too large, adequate or too small. The question was only directed at middle managers, since they were more directly concerned with everyday work, personnel issues and what actually happened in production units. As evident in table 8.9, 52% of managers thought the work force was too large, while 27.9% found it adequate and only 1% felt it was too small.

**Table 8.9: Adequacy of Staff Size in Managers' Opinions**

| Responses → / Managers' Classification ↓ | Too large | Adequate | Too small | Not Sure | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|
| All Managers | 47.1 | 27.9 | 1.0 | 2.4 | 100 | 76.7*** | 6.32 |
| Industrial Companies | 39 | 24.4 | 0.0 | 36.6 | 100 | 26.005*** | D.F=3 NS |
| Non-Industrial Companies | 52.4 | 30.2 | 1.6 | 15.9 | 100 | 55.94*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The Chi-square tests show that while statistical differences in distribution within the same groups are different from what would be expected on a chance basis, differences among the different groups are statistically insignificant.

## 8.9.3 Managers' Views Concerning Departments with Highest Labour Redundancy (Quest. B-Q24)

Next the managers were asked to identify in which department/departments the problem of redundant labour was more evident. Their answers are reported in table 8.10 in which the numbers in the top row refer to one of the following options:

*1- In all departments.*
*2- In administrative departments.*
*3- In financial departments.*
*4- In the service and support departments.*
*5- In technical departments.*
*6- In marketing departments.*
*7- Our company does not have a problem.*
*8- In the production departments.*
*9- In the control department.*

**Table 8.10: In which Department is the Problem More Evident?**

| Responses → / Managers' Classification ↓ | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | 27.1 | 31.4 | 2.9 | 20.0 | 4.3 | 1.4 | 0.0 | 11.4 | 1.4 | 100.0 | 98.8*** | 5.474 |
| Indus. Co. | 21.4 | 39.3 | 0.0 | 17.9 | 3.6 | 0.0 | 0.0 | 14.3 | 3.6 | 100.0 | 22.857*** | D.F= |
| Non-Indus. Co. | 31.0 | 26.2 | 4.8 | 21.4 | 4.8 | 2.4 | 0.0 | 9.5 | 0.0 | 100.0 | 23.966*** | 7 NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The most frequent answer (31.4%) was the administrative department, especially in industrial companies (39.3%). The next most frequent answer (27.1%) was that the problem existed in all departments. Furthermore, 20% of the respondents thought the problem was more evident in the services and supporting departments. An interesting fact was that none of the respondents thought that the problem did not exist in any of the departments. More information can be secured at company level.

The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. The differences related to whether the company is industrial or non-industrial are statistically insignificant.

## 8.9.4 Managers' Views Concerning the Most Appropriate Bases of Promotion (Quest. B-Q35)

Managers were asked to state what they thought should be the fair criteria for promotion. They were offered four choices and were encouraged to propose any others that were not mentioned. The options offered were (the numbers in the top row of table 8.11 refer to these options):

1. *Seniority.*
2. *Efficiency.*
3. *Ability to develop new ideas.*
4. *Experience.*
5. *Others.*

**Table 8.11: Managers' Views Concerning Different Bases of Promotion**

| Responses → / Managers' Classification ↓ | 1 | 2 | 3 | 4 | 5 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|
| All Managers | 10.7 | 77.7 | 6.8 | 1.9 | 2.9 | 100.0 | 266.6*** | 6.164 |
| Indust. Co. | 9.8 | 87.8 | 2.4 | 0.0 | 0.0 | 100.0 | 112.49*** | D.F=4 |
| Non-Indust. Co. | 11.3 | 71.0 | 9.7 | 3.2 | 4.8 | 100.0 | 98.07*** | NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

A large majority (77.7%) of managers, whether in industrial companies (87.8%) or non-industrial companies (71%) thought that efficiency should be the basis for promotion. Only 10.7 % of the managers agreed that the present system based on seniority was a better system. A low percentage chose other options. This indicates that managers (the most affected) would not resist changing the promotion system to a more efficient system based on efficiency.

The Chi-square tests show that, while statistical differences in distribution within the same group are quite different from what would be expected on a chance basis, differences among the different groups are statistically insignificant.

## 8.9.5 Managers' Opinions concerning Efficiency of Incentive System used in PEs (Quest. B-Q 34)

Managers were also asked to rate the incentive systems used in PEs, utilizing a five-degree scale in which (1) indicated the highest rating while (5) indicated the lowest rating.

**Table 8.12: Managers' Views Concerning Efficiency of Incentive System Used in PEs**

| Responses → / Managers' Classification ↓ | 1 | 2 | 3 | 4 | 5 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|
| All Managers | 21.2 | 27.9 | 8.7 | 35.6 | 6.7 | 100.0 | 53.9*** | 2.699 |
| Indust. Co. | 22.6 | 26.8 | 7.3 | 41.5 | 2.4 | 100.0 | 17.23** | D.F=4 |
| Non-Indust. Co. | 20.6 | 28.6 | 9.5 | 31.7 | 9.5 | 100.0 | 15.84** | NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

Many managers (42%) gave the incentive system either a very low rating or low rating. Only 21.6% gave the existing system a very high rating. This shows the need for improving incentive systems.

The Chi-square tests show that distribution of differences within each group is different from what we would expect on a chance basis. However statistical differences due to whether the company is industrial or non-industrial are insignificant.

## 8.9.6 Managers' Opinions Concerning which Type of Company they Would Prefer to Work in, Private or Public (Quest. B-Q32)

Managers were asked which type of company they would prefer to work in. As shown in table 8.13 over one-third (36.3%) of the managers, whether in industrial (39%) or non-industrial (34.4%) companies, felt it did not make a difference to them. With a very slight decrease in percentage managers who preferred to work in the private sector accounted for 35.3%. Although most managers either did not mind working or preferred working in the private sector, there were still a number of managers (28.4%) that preferred to work in the public sector. Reasons for their preference should be investigated and addressed. Managers who prefer working in the public sector are more likely to resist implementation of privatization.

**Table 8.13: Managers' Opinions Concerning which Type of Company They Would Prefer to Work in**

| Responses → / Managers' Classification ↓ | Public Sector | Private Sector | No Difference | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|
| All Managers | 28.4 | 35.3 | 36.3 | 100.0 | 26.9*** | 0.23 D.F=2 NS |
| Indust. | 26.8 | 34.1 | 39.0 | 100.0 | 0.925 NS | |
| Non-Ind. | 29.5 | 36.1 | 34.4 | 100.0 | 0.545 NS | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The Chi-square tests show that distribution of differences within each group is different from what we would expect on a chance basis. However statistical differences due to whether the company is industrial or non-industrial are insignificant.

### 8.9.7 The Most Important Advantages of Working in a Public Sector Company from the Managers' Point of View (Quest. B-Q29)

Identifying the most important advantages of working in PEs perceived by managers is a useful step before designing compensation packages which might make managers more favourably inclined towards privatization and working in a private enterprise.

Managers were asked to indicate their views on the most important advantages of working in a PE. Six options were presented to them and they were encouraged to add any other advantages that they thought were important. The options presented to them were:

1. *Security.*
2. *Vacations.*
3. *Financial Advantages.*
4. *Insurance & Pensions.*
5. *Health Care.*
6. *No Work Pressure.*
7. *Other Advantages.*

Table 8.14 summarizes their answers.

**Table 8.14: The Most Important Advantages of Working in a Public Sector Company from the Managers' Points of View**

| Responses → <br> Managers' Classification ↓ | 1 | 2 | 3 | 4 | 5 | 6 | 7 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | **77.3** | **3.1** | **4.1** | **8.2** | **3.1** | **1.0** | **3.1** | **100.0** | **331.6*** ** | **2.367** |
| Indust. Co. | **76.9** | **2.6** | **2.6** | **10.3** | **5.1** | **0.0** | **2.6** | **100.0** | **117.58*** ** | **D.F=** |
| Non-Ind. Co. | **77.6** | **3.4** | **5.2** | **6.9** | **1.7** | **1.7** | **3.4** | **100.0** | **181.65*** ** | **6 NS** |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

As evident, a large majority of managers selected security as the most important advantage of working in the public sector. This has to be clearly kept in mind in planning privatization. To make the work force desire privatization they must be offered alternatives that give them this feeling of security or adequate compensation for loss of security.

The Chi-square tests show that distribution of differences within each group is different from what one would expect on a chance basis. However differences due to whether the company is industrial or non-industrial are statistically insignificant.

## 8.9.8 Managers' Opinions Concerning Early Retirement Compensation Schemes (Quest. B-Q.26)

Whether managers would accept cash or asset compensation for early retirement was tested. Managers' responses are summarized in the following table:

**Table 8.15: Would Managers' Accept Early Retirement Compensation Schemes**

| Responses → / Managers' Classification ↓ | Yes | No | Maybe in the future | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|
| All Managers | 47.6 | 15.5 | 36.9 | 100.0 | 49.1*** | 7.627* |
| Industrial Co. | 63.4 | 7.3 | 29.3 | 100.0 | 17.86*** | D.F=2* |
| Non-Indust. Co. | 37.1 | 21.0 | 41.9 | 100.0 | 4.48 NS | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

Nearly half the managers overall (47.6%) and more in industrial companies (63.4%), declared they would accept such a scheme. More than one third said that they could make that choice in the future. This reflects the acceptability of such a scheme among middle level managers who have the experience to start new businesses. Most of those who did not find the scheme acceptable at present, stated that they might in the future. This group could be convinced to accept early retirement through more communication of different success stories of managers who chose that scheme or a better compensation package.

The Chi-square tests show that distribution of responses is statistically different from what one would expect on a chance basis for both the grand total of managers and for the managers in industrial PEs. Statistical differences due to whether the company is industrial or non-industrial are significant.

### 8.9.9 Managers' Opinions Concerning Purchase of Company Shares (Quest. B Q25)

Managers were asked whether they would buy the company's shares if offered at a reasonable price and become owners. Only 55.3% stated that they would while 44.7% said they would not. Although managers in industrial PEs (58.5%) and non-industrial PEs (53.2%) willing to purchase their own companies' shares were in the majority, the large minorities of managers who were unwilling to purchase shares throws doubts on the acceptability and success of a compensation scheme based on distributing company shares.

**Table 8.16: Managers' Opinions Concerning Purchase of Company Shares**

| Responses → / Managers' Classification ↓ | Yes | No | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|
| All Managers | 55.3 | 44.7 | 100.0 | 46.1*** | 0.864 |
| Industrial | 58.5 | 41.5 | 100.0 | 1.195 NS | D.F=1 |
| Non-Indust. | 53.2 | 46.8 | 100.0 | 0.41 NS | NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

## 8.9.10 Managers' Opinions Concerning Training and Retraining (Quest. B-Q27)

Another option tested is managers' preference for starting a new business as opposed to training/ retraining to suit the new company needs. The question used was:

*If you were asked to choose either to get trained on new systems in your employing company or start your own small project (within financial reach) which would you choose.*

*A- My private project.*

*B- Retraining.*

*C- Undecided. Why?*

Tables 8.17 and 8.18 summarize the answers. Among the reasons the managers have stated for choosing to start their own project were:

*1- It would give me freedom of decision-making.*

*2- My age and experience are assets that will help me.*

*3- I'm ready if I get help from the Government e.g. credit.*

*4- To receive suitable compensation for my effort and work.*

*5- This would be a better investment for both me and the Government.*

Among the reasons that the managers have stated for choosing training or retraining were:

*1- To increase my efficiency so that I could continue in my company.*

*2- Private projects are beyond my budget.*

3- *To retain stability and keep away from risk especially at my age.*

4- *Private projects need special experience I don't have.*

5- *It's not a good time to start a new project (regression).*

Many of the managers have not stated reasons for making their choices.

**Table 8.17: Managers' Choice between Establishing a Project and Being Trained or Retrained**

| Responses → / Managers' Classification ↓ | Starting a business | Training or Retraining | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|
| All Managers | 43.4 | 56.6 | 100.0 | 79.8*** | 0.72 D.F=4 NS |
| Industrial Co. | 45.0 | 55.0 | 100.0 | 0.4 NS | |
| Non-Indust. Co. | 42.4 | 57.6 | 100.0 | 1.373 NS | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

**Table 8.18 Why Managers Made that Choice?**

| | Responses → / Managers' Classification ↓ | 1 | 2 | 3 | 4 | 5 | Unmentioned | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|
| Business | All Managers | 5.5 | 12.3 | Negligible | 4.1 | 2.7 | 75.3 | 100.0 | 66.6*** | 2.943 D.F=4 NS |
| | Industrial Co. | 9.7 | 9.7 | Negligible | 6.5 | 3.2 | 71.0 | 100.0 | 0.313 NS | |
| | Non-Indust. | 2.4 | 14.3 | Negligible | 2.4 | 2.4 | 78.6 | 100.0 | 5.29 NS | |
| Training | Grand Total | 13.2 | 4.4 | 4.4 | 11.8 | 2.9 | 63.2 | 100.0 | 90.5*** | 8.378 D.F=5 NS |
| | Industrial | 12.5 | 3.1 | 9.4 | 18.8 | 0.0 | 56.3 | 100.0 | 5.27 NS | |
| | Non-Indust. | 13.9 | 5.6 | 0.0 | 5.6 | 5.6 | 69.4 | 100.0 | 3.72 NS | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

More managers prefer (56.6%) training or retraining and staying in their company to starting their own business (43.3%). This preference was evident in both industrial companies (55%) and non-industrial companies (57.6%). When asked to state reasons for their choices most managers did not answer. However among those who answered, the most frequent reason (12.3%) for choosing to start a new business was that their experience and capabilities would allow them to do so. The most frequent reason (13.2%) mentioned for choosing training and retraining was to increase their efficiency. The next frequent reason was that they lacked the experience of starting a new business.

These answers reflect the fear of starting a new business. This has to be taken into account in designing voluntary retirement schemes built on offering cash assets or credit to start projects. Alternative projects could be proposed and training could be offered to encourage managers to choose starting their own businesses. They could also be encouraged to take unpaid leave until they found alternative employment or self-employment. Also, if subcontracts of products and services of the same company were offered they would have the necessary experience and might be more encouraged to accept that option.

The Chi-square tests show that distribution of statistical differences within the grand total of the responses is different from what one would expect on a chance basis in both tables. However, differences within the industrial and non-industrial groups, and due to whether the company was industrial or non-industrial were statistically insignificant in all cases.

### 8.9.11 Managers' Acceptance of Help in Finding Alternative Employment (Quest. B Q28)

Managers were asked whether they would accept being transferred, carrying the same financial advantages, to another company working in a field similar to their own company but in more need of their services. 48.9% of the managers responded they would (54.1% in industrial PEs and 45.5% in non-industrial ones). Overall, the proportion willing to transfer was higher than the proportion not willing. However, there was a sharp difference between the proportions in industrial and non-industrial companies. A possible reason is that managers from the latter felt less secure because of concerns about their ability to transfer their skills into another enterprise or a greater threat of redundancy in non-industrial companies.

**Table 8.19: Managers' Acceptance of Transfer to Other Companies**

| Responses → / Managers' Classification ↓ | Yes | No | Undecided | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|
| All Managers | 48.9 | 45.7 | 5.4 | 100.0 | 45.3*** | 2.375 |
| Indus. | 54.1 | 40.5 | 5.4 | 100.0 | 12.42** | D.F=6 |
| Non-Indus. | 45.5 | 49.1 | 5.5 | 100.0 | 17.74*** | NS |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The Chi-square tests show that distribution of statistical differences within each group is different from what one would expect on a chance basis. However differences due to whether the company is industrial or non-industrial are statistically insignificant.

### 8.9.12 Managers' Awareness of the Social Fund and their Opinions Concerning its Usefulness (Quest. B Q 30)

The SFD (see section 8.9) was mainly established to help those negatively affected by the Economic Reform Programme and privatization. This is why it was found important to study managers' awareness of its role and their opinions towards its usefulness. The following question has been used to do so:

*Have you heard about the Social Development Fund, meant to help employees and workers, and if so do you think it is useful?*

*1- Yes, I've heard of it and I believe it's useful.*

*2- I don't know anything about it.*

*3- I know about it , but I think it's not useful.*

Answers are summarized in table 8.20 where the top row refers to one of the three options.

**Table 8.20: Managers' Awareness of the Social Fund and their opinions concerning its usefulness**

| Responses → / Managers' Classification ↓ | 1 | 2 | 3 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|
| All Managers | 62.9 | 21.0 | 16.1 | 100.0 | 34.7*** | 0.038 D.F=2 NS |
| Industrial | 63.3 | 20.0 | 16.7 | 100.0 | 12.2** | |
| Non-Industrial | 62.5 | 21.9 | 15.6 | 100.0 | 12.4** | |

(1) All figures are expressed as percentages of row total.
(2)*Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

A large majority (62.9%) know about the Social Fund and think it is useful. Surprisingly 21% of the managers had not heard of it (20% in industrial PEs and 21.9% in non-industrial ones). Another considerable number (16.1%) had heard of it, but thought it was not useful. This reflects the need to improve the effectiveness of the

Social Fund or clarify its role to the managers so that they would be able to utilize it and clarify it to their subordinates.

The Chi-square tests show that distribution of statistical differences within each group is different from what one would expect on a chance basis. However statistical differences due to whether the company is industrial or non-industrial are statistically insignificant.

## 8.10 Case Study: The Alexandria Shipyard Company

Labour restructuring in SOEs and absorption of excess labour are pre-requisites of successful privatization. This is the main reason the researcher found it adequate to perform a case study in one of the projects undergoing labour restructuring to investigate whether there are problems or difficulties encountered in the process at the enterprise level.

As mentioned earlier 'The Social Fund for Development' (SFD) is involved in a number of labour restructuring programmes in different SOEs. The Alexandria Shipyard Company is among the biggest of these projects. This is why it was chosen by the researcher as a subject of study. A number of interviews were carried out with relevant personnel in the company undergoing restructuring, including top and middle managers and representatives of workers. Similar interviews were also carried out in SFD. The objective of the field work was to get the information needed, to solicit opinions and attitudes and to assess options. In addition to that documents and records related to the problem were thoroughly examined by the researcher.

The case demonstrates how the labour restructuring problem is dealt with in practice and the role of SFD. It also presents the different schemes that have been applied and the extent of their success in a real-life situation. Further, it shows the costs involved and the problems that might arise in labour restructuring and how it could affect the company.

The labour restructuring project was implemented in two stages. The first stage started in 1992 and was terminated two years later and replaced by another ongoing, 5-year project that started from where the first one had stopped.

## 8.10.1 Company Background

The Alexandria Shipyard was established in 1964, with capital of LE 30.6 million that had increased to LE 115 in 1990. Its main objective was to cover national needs for building and repair of naval vessels. Actual production started in 1970 as an affiliate to the Public Authority for Maritime Transport and in no time the shipyard became one of the largest in the Middle East

The shipyard is a self sustained production complex that has 20 workshops, plants, power stations, a fleet of trucks, buses, fork lifts and cranes and an apprentice school. Its main activities are shipbuilding, ship repair, oil drills and oilrigs, manufacture and repair of containers, construction and production of wooden and metallic works and equipment. It also carries out maritime activities, modification and scrapping of ships and maintenance of fibreglass boats.

Workforce in 1992 was estimated at 6300, including 1000 temporary workers. The revenue realized in 1992 was LE 90 million with a total loss of LE 64 million for the same year. The value of the total number of contracts in hand was LE 627 million. Up to 1992 it had successfully built 30 ocean-going vessels.

**The Company Problem**

The company started very successfully and was able to acquire a good reputation in shipbuilding and repair. Its technical performance was excellent and its future was promising. Suddenly, at the beginning of the 1980s the yard started facing a fall in demand due to the gradually diminishing local market. The only way out was to move into the international market. Unfortunately the shipyard lacked design and finance capabilities to compete internationally.

Financial troubles started to emerge in the yard, and it started to suffer from shortage of liquidity. In 1991/1992 the overdraft reached LE 300 million and the total debt interest reached LE 26.3 million. The shipyard also suffered a high cost of currency exchange difference of LE 90 million on loans from international donors.

❖ **Complete Diagnosis**

As part of implementation of the privatization programme, Alexandria Shipyard planned labour restructuring. To determine the actual needs for restructuring, the shipyard management executed diagnostic studies together with international consultants to identify the problem areas and to determine their adverse effects on privatization and hence efficiency and competitiveness. The following points summarize the major findings:

- Excess workforce that had to be trimmed from 6300 to 2700 persons.
- Wages and benefits represent 70% of the revenue.
- Low productivity levels and lower capacity utilization characterized operation.
- The technology and machinery used were outdated.
- Management and control systems were inefficient.
- Production costs were too high.
- Debts were at a dangerously high level.
- Losses were increasing every day.

### 8.10.2 Role of the Social Fund For Development

Since the SFD was established to assist restructured and laid off workers by qualifying and helping them find new jobs to enter the labour market and be productive, the management of the shipyard decided to solve the problem of excess workforce by coordination with the SFD labour adjustment programme.

❖ **The First Approach (Part of a Larger Comprehensive Restructuring Scheme)**

The initial programme started in 1992 as part of a comprehensive restructuring plan, with a .target group of 1500 of the redundant workers to be dealt with in three distinct phases.

- **Phase One** (24 months): Restructuring and upgrading the skills of 500 redundant workers and re-employing them after training in specializations in which there was a shortage in the company. Training was to take place in the company's training centres after upgrading it and the trainees would be tested by the American

International Association[12]. A questionnaire was prepared and distributed to find out workers' preferences and to redistribute them accordingly in the different training programmes. The total grant for the project was LE 1,594,580.

- **Phase Two** (18 months): The targeted group for this phase was 800 workers to be offered credit to start their small-scale business in 22 different activities. The shipyard was to provide them with suitable space and equipment to start their businesses. The plan for this phase was to be made during the implementation of the first phase.

- **Phase Three** (12 months): Included about 200 workers, to be divided into two groups. The first group would be provided with credit to start their own group business for which a feasibility study of the activity would be conducted determining the main features of the project. The second group would be provided with training in skills for which there is market need. The plan for this phase was to be made during the second phase.

However, this programme was terminated two years later before completing the first phase. The programme was then re-planned resulting in the on-going project. The first phase was considered the first option of the new project. The rest of the comprehensive restructuring programme was continued and the Holding Company for Maritime Transport was able to clean up the shipyard balance sheet in June 1997.

❖ **The Second Approach (the Ongoing Labour Restructuring Programme)**

The second project of labour restructuring was planned in coordination with foreign donors in 1993. The project was to consist of six optional programmes of which some were totally financed by the Social Fund and some partially financed by the donors.

The first step of the programme was to determine the extent of labour redundancy and how much labour should be rationalized. Studies were carried out to examine the workforce structure, demographics, productivity, capital labour ratios, skill levels structure (need for upgrading training to cover shortage in some trades), pension liability patterns, absenteeism and unpaid leave. A coordinating and monitoring committee was also established consisting of the chair (having no voting rights), three

[12]The American International Association has the authority to certify qualified welders .

company representatives (managers from the planning, finance and human resources departments), three members representing the work force (from the union, group leader, and training instructor) and one external member. Six optional programmes were then offered as an integrative labour-restructuring scheme:

- **Programme No. 1: Training and Retraining**

The first was a voluntary programme focused on refreshing, upgrading and mobility training. The programme was complementary to the first restructuring project but was delayed for eight months due to opposition and re-scheduling. The programme targeted 500 workers (400 certified welders, 20 cranes operators, 60 hull assembly workers and 20 painters). The costs of the programme (LE 1.6 million) were completely covered by the Social Fund for Development. The project was completed in 1995.

The main problem that faced the implementation of this programme was that after training many of the redundant workers in specializations for which there was a shortage in the shipyard many preferred to leave the company and start their own businesses rather than be re-employed in the company. Although the objective of the whole plan was reducing redundant labour this was not the aim of this special programme. However, training costs could be considered costs of support for workers to start their own businesses. Compensation could be reduced by the value of training.

- **Programme No. 2: Voluntary Early Retirement (Option One)**

This programme aimed to encourage workers to opt for voluntary retirement. It targeted 500 workers (men over 50 years and women over 45 years old). The costs of the programme added up to L.E 15 million, which would be partially covered by SFD (30% with a cap of LE 7000 per worker) and partially by donors (32 months payback period). The programme was first delayed for four months due to opposition of labour unions, but was then successfully resumed and completed in August 1997.

The formula used to determine the cash compensation is described in box 8.3.

**Box 8.3: Alexandria Shipyard Cash Severance Formula**

Compensation in LE-

$$\text{(To Date Basic Salary + Benefits)} \times \underline{(60 - \text{Age})} \,\}+ \{\, \text{Basic Salary} + 40\}$$
$$2$$

Cash severance compensation calculated according to this formula ranged between L.E 15,000 and L.E 47,000 per worker. The five hundred targeted workers had left the company by August 1997. The programme proved to be very attractive for many of the workers and employees and gave very successful results. The annual savings due to the decrease in redundant labour were LE 4.5 million with no effect on company performance.

- **Programme No. 3: Voluntary Early Retirement (Option)**

This on-going programme was targeted for 1000 workers. The first group of them are men under the age of 50 years old and the second group are women below 45 with 20 years of service as a minimum. The total cost of the programme was estimated to be LE 26.6 million that would be totally covered by the SFD with a pay back period of 28 months.

The formula used to calculate the cash compensation was that used in (option 1), but after imposing a L.E 30,000 top cap for each individual compensation. The compensation amounts ranged between L.E 8000 and L.E 30,000 per worker. Until the end of 1997, 520 persons left the company under this scheme.

- **Programme No. 4: Voluntary Resignation after Receiving the Ownership of a Modular Workshop**

This programme was still subject to appraisal by the Social Fund (at the beginning of 1998). It is aimed at 200 workers who would be offered a modular workshop upon voluntary resignation. The workshops would be established in an old unutilized company storage area costing around L.E 30,000 for each workshop. The costs were to be initially covered by the SFD and then credited to the workers. Costs of the whole programme were estimated at around L.E 6 million.

- **Programme No. 5: Creation of New Jobs in the Private Sector**

The social Fund has financed a feasibility study for the establishment of a medium size company for ship demolition on the premises. The private sector was to be allowed to own and operate it. The aim was to transfer 500 semi-skilled and skilled workers to move to the new company. The study was completed in October 1997. Costs of operating it reached LE 2,500,000 and were covered completely by the SFD.

- **Programme No. 6: Encouraging Labour to Undertake Long-term Unpaid Vacations**

This programme aimed to encourage labour to undertake long term unpaid leave. It could be utilized by workers to try alternative employment or even start their own businesses. However, this programme was still in the preparation phase in 1998.

## 8.10.3 Results of Implementing the Labour Restructuring Project[13]

- The four implemented programmes successfully trimmed the work force from the initial 6300 to 3966 by August, 1997. The number was expected to decrease to 2200 by January 1998.
- The financial gain (concentrated in wages and benefits reduction due to early retirement) is about L.E 13.5 million annually and there is no loss in productivity.
- The delay in privatization to implement labour restructuring programmes and cleaning the balance sheet led to decreased productivity and heavy reduction in the work load which again created a need for repeated workforce reduction and training programmes to balance the skills and workforce distribution.
- Appreciably improved labour relationships have been established to a large extent

## 8.10.4 Proposals by the Interviewee "Proposed Rescue Plan[14]"

- Speed up privatization by concentrating on spinning out non core activities first:

  -Infra structure and services

  -Ship demolition

[13] As Stated in an Interview with Manager of the Labour Adjustment Programme in the SFD

[14] In the words of the Manager of the Labour Adjustment Programme in the SFD

-Engineering works

-Cleaning and painting of ship hulls

- Privatized services can than be subcontracted
- Core activities can be privatized at a later stage without further technical/ technological restructuring or investing in development or modernization. The following sequence is suggested:

-Ship repair docks

-Ship berths and O/F shops

-Small boat building and ship repair

## 8.10.5 Demographics after Implementation of Labour Restructuring Programmes

The following table shows the number of workers after implementing the labour adjustment programmes. By comparing them to the 1992 figures included in the tables at the end of the case, the difference is evident.

**Table 8.21: Workers Classified by Age Groups as of August 15th, 1997**

| Age Brackets | Number of Workers |
|---|---|
| Less than 25 years old | 20 |
| 25 to 29 | 85 |
| 30 to 34 | 608 |
| 35 to 39 | 589 |
| 40 to 44 | 940 |
| 45 to 49 | 847 |
| 50 to 54 | 447 |
| 55 to 57 | 214 |
| 58 to 60 | 215 |
| **Total** | **3966*** |

**This number includes those on unpaid leave ( 343 males and 22 females), the rest includes 3507 males and 94 females*

*Source: Alexandria Shipyard Company*

### 8.10.6 Researcher's Comments

- This case shows the role of SFD in dealing with the labour redundancy problem.
- It demonstrates how the labour restructuring problem is dealt with practically showing the different schemes and the kind of costs they involve.
- The case also shows the importance of applying comprehensive restructuring schemes in parallel with labour restructuring programmes to upgrade the performance of the whole company and prepare it for privatization.
- Furthermore, it demonstrates the importance of speeding up privatization of non-core activities to decrease the restructuring load and help in financing restructuring schemes.
- The case also shows extent of acceptability of the different alternative labour schemes among workers. This could be summarized as follows:

- Cash compensation separation payments are usually welcome by workers, especially if adequate sums are offered to counterbalance the rights lost due to early retirement.
- Re-training in alternative skills to re-employ specializations in which there were shortages proved to be less successful than offering workers a chance to be self-employed especially in technical jobs.

- The case shows the importance of training programmes that are meant to increase productivity of workers and employees continuing in the company. In this case, this was overlooked which resulted in a decrease in production and productivity.
- However, it is evident from the case that the same compensation packages were offered to skilled and unskilled workers. This has resulted in this case in loss of many productive skillful workers who were not targeted by the scheme. Managers complained that after applying the schemes many of the experienced workers left the company and chose one of the voluntary schemes meant for redundant labour. This also resulted in a decrease in production and productivity after the different schemes were applied. This could have been avoided by directing different schemes at different workforce categories or maybe creating adequate incentives based on

production and efficiency levels that would attract and encourage them to choose to stay.

- Finally, the case shows the substantial amounts of money companies could save by implementing labour restructuring programmes promptly and not delaying them for fear of labour resistance. In fact, the case shows that voluntary retirement and attractive compensation packages are acceptable to workers in most cases. So if these compensation plans are less costly to GOE than keeping the workforce, one wonders why they are not applied, at a quicker rate, in all companies with redundant worker problems.

## 8.11 Conclusion

### ❖ General

The above analysis leads to the following conclusions:

- The Sixties transferred disguised unemployment in Egypt from the village to urban areas, while the Eighties brought unemployment to the open. Analysts put redundancy at around 30% of the workforce.
- Most of the unemployed are newly graduated, educated youth holding either intermediate qualifications or higher education degrees.
- The surest way out of the unemployment dilemma is by expanding the absorptive capacity of the labour market mainly through increasing investments. Hopefully, the reform policies lead to the desired investments and hence increase jobs in the labour market.
- To be feasible, privatization has to be desired by most managers, employees and workers. They must feel secure about their jobs and careers if they are to continue in the company and know what their options are if they choose to or are compelled to leave. Otherwise, the work force could form considerable resistance that could represent a serious obstacle to implementation of privatization. Desirability of privatization could be enhanced by offering viable options to laid off workers.
- The present Labour Law (137 of 1981) is one of the main constraints obstructing effective management of the Egyptian workforce and reduction of labour redundancy. The law biased in favour of labour makes it nearly impossible

for an employer, whether public or private, to adjust his enterprise's work force on economic grounds.

- The schemes that can help solve the redundant labour problem are given below. Most of them were tried in Egypt with varying degrees of success.
  - Cash payment for severance.
  - Early retirement while keeping pension rights.
  - Offering unneeded company assets at severance.
  - Offering shares through "Employee Shareholders Association".
  - Subcontracting the provision of goods and services to departing employees.
  - Offering credit for departing employees to start up businesses.
  - Training and retraining.
  - Encouraging labour to undertake long-term unpaid vacations.
  - Help in finding alternative employment.
  - Link incentives and bonuses to real productivity.
  - Developing existing legal framework.
  - Simple attrition through retirement.
  - Establishing a centralized authority for solving problems of redundant labour.
- Combining several of these schemes can form attractive packages. The most appropriate package should be chosen on a case-by-case basis according to each company's circumstances and the attitudes of its workforce, but one common feature that has to exist within the Egyptian legal context is that all of them have to be voluntary schemes. Different packages could be offered for different sectors of the labour force.
- The SFD has performed an active role in solving the problem of youth desiring to build new projects, but that was at the expense of helping redundant labour, which was its initial objective.

### ❖ Managers' Views

- Most managers consider worker resistance a major hindering factor to privatization. Since most of the resistance stems from the fear of resulting job losses, it is of utmost importance to develop appropriate schemes for redundancy and possible unemployment.

- According to managers, the problem of redundant labour exists mostly in administrative, service or supporting departments. Using more detailed case-by-case studies can derive more precise information.
- The majority of managers, whether in industrial or non-industrial companies, think that efficiency should be used as the fair basis for promotion, replacing the existing system based on seniority. They also think that the incentive systems applied were not efficient.
- Most of the managers whether in industrial or non-industrial companies view "security" as the most important advantage of working in the public sector.
- Cash and asset compensation early retirement schemes seem to be highly acceptable among middle level managers. Even those who were hesitant to accept at the time of the survey think they might accept in the future. Offering shares seemed to be less attractive for them.
- When managers were asked whether they would choose retraining to stay in the company or to start their own business, if they had the choice, many of them chose staying in their company mainly out of fear of failure in an independent business because of lack of private sector experience. This has to be taken into account in designing voluntary retirement schemes built on offering cash, assets or credit to start projects.
- There is a need to clarify the role of the Social Fund for Development to managers so that they would be able to utilize it and to clarify it to their subordinates. Again more communication is needed.
- Finally, despite managers' agreement with the policy of privatization and the adequacy of most of the compensation packages offered, many of the managers admit their preference to stay in their own SOEs. An increased sense of security and fear of lack of experience in alternative employment are their main reasons for this preference. This leads one to question whether the compensation packages are attractive enough for the managers. Are they sufficient to make managers feel secure about their careers and futures? Are there enough incentives for managers to choose the comparatively risky route of private enterprise? Should managers be offered special tailored schemes rather than the same schemes offered to the rest of

the workforce? It is the researcher's view that if these packages are not attractive enough, as seems to be the case, then it is doubtful that the managers would have a genuinely positive attitude towards implementing labour restructuring and privatization or leaving public sector employment.

- **Findings of Case Study Analysis**

Analysis of the case study demonstrated the labour restructuring process in a loss making PE in which redundant labour is a major problem. The case shows how SFD is involved in the process and gives an indication of the costs that are incurred in such schemes. In this study cash compensation severance payments were more welcome by workers, compared to other compensation methods. Also, re-training in alternative skills to re-employ in specialization in which there were shortages proved to be less successful than offering workers a chance to be self-employed especially in technical jobs. Although these conclusions cannot be generalized, they do give an idea of the preferences of workers especially in similar industries. However, more general results can be ascertained by comparing this to results of the attitude survey where it was found that middle managers in industrial companies seemed to prefer early retirement compensation schemes. Finally, the case shows the substantial amounts of money that could be saved by implementing labour restructuring programmes without delay.

# Chapter Nine

# Valuation of Assets and Companies

## 9.1 Introduction

*"The main problem in selling PEs is valuation. Part of our job is stressing to responsible Government personnel that they are capable of reaching the correct, just value of the nominated company. Responsible Government representatives usually have fears that they would be blamed for under-valuing the companies' assets. Another problem is their concentration on the immediate price of sale and overlooking the future gains represented in taxes, employment and attraction of investments and technology."* (Ebeid, 1998)

While fair and just valuation is one of the cornerstones of successful privatization, this quotation summarizes the problems faced in arriving at a satisfactory valuation. Whether the objective of valuation is the sale of a whole company or the sale of part of its assets or shares, fear of undervaluing it, or at least being accused of doing so, always influences the selling committee. At the same time the committee is not free to raise the price to what would diminish that fear. They have to find a buyer who is ready to pay the price they determine. Torn between these two forces the selling committee always finds it a problem to value companies especially when determining prices for anchor sales. Another problem that makes the valuation task difficult for the officials is that book values do not reflect the real market value of the company making valuation more difficult.

This chapter discusses the problem of valuation of assets, companies and shares showing how it is related to privatization and whether it represents a problem in implementation. Firstly, it discusses the role of price and valuation and then demonstrates how valuation differs according to its purpose and the method applied. It then briefly discusses the information needed for valuation. Different pricing mechanisms and methods are then examined together with the factors affecting the valuation process. Share valuation mechanism and valuation of projects for sale to major investors are then studied. The researcher then demonstrates several problems of valuation of Egyptian public enterprises. Finally, attitudes and views of managers concerning valuation methods, who should be in charge and the expected accuracy of valuation are analyzed. A case study was carried out on valuation problems and findings are presented. The case chosen is one of the earliest cases of privatization in Egypt where the sale was actually concluded.

## 9.2 The Role of Valuation and Price

Different items have different values for different persons. This is the main motive behind exchange and trade. A buyer is willing to pay a certain amount of money in order to receive a value that he thinks is greater than the value he is paying. At the same time the seller is ready to sell if he feels that the price he is offered exceeds the value of the item he is selling. *The selling price is mainly a compromise* between these two values, so that both the seller and purchaser feel they gained otherwise no sale would take place.

This concept was summed up by Jones et al (1990):

- Assets are sold when buyers and sellers value them differently, thus creating a positive-sum game where both parties can gain.
- The selling price of the asset is the intervening variable that allocates the benefits of the game.

Profitable firms are sold in many cases because the price offered exceeds what the seller expects to earn in the future, while the buyer believes he can earn more. At the same time, unprofitable firms can be sold at a positive value if the buyer believes that changing management systems will create future profits. Both parties may apply different valuation methods, techniques and assumptions to arrive at the most adequate price depending on their different priorities and expectations of future gains. Accordingly, whether a firm is profitable or unprofitable is of secondary importance, since the difference in the valuation is what makes a trade possible.

## 9.3 Differences in Valuation of Assets and Companies According to the Different Purposes and Methods Used

Valuation of assets and companies is a technical professional study, which aims at estimating the value of certain assets or companies that would be accepted by the market. It is natural that valuation differs in form, method and result according to its purpose. Valuation made for the purpose of liquidation differs from that made for the purpose of continuation of activity. Likewise, valuation for purposes of exchange may differ from that made for investment purposes. In the world of business, valuation has different objectives. The valuation of a company as a going concern is different from the total value of the available assets inside the company.

The two basic approaches to valuation are the accounting based valuation method that aims at showing the accounting values of assets and the economic value method that depends on estimating the "real" value of assets. The accounting method usually depends on the historical value of the assets while the economic method reflects its market value or the value of projected income. Accounting valuation relies on the acknowledged accounting rules under the principle of continuity whereas economic valuation depends on other factors. Among these factors are the cost of the general and private alternative charges, the interest rate, inflation rate, the present and future conditions of the assets, the expected taxation treatment of future inflows, the scrap value of assets and the expected period of investment in addition to a group of environmental, legal and behavioural factors (Hendy, 1997).

It is also necessary to have a number of purchasers who are ready to acquire these assets or shares in companies against payment or undertaking of payment of certain amounts of money or assignment of some of their possessions or through any other means of payment.

It is noteworthy to point out the fact that the valuation of assets is easier than that of companies. This is mainly because the company is made up of many tangible and intangible assets and other owned elements associated with the presence of the company and which might lose their value when the company undergoes any change.

## 9.4 Information Needed for Valuation

No matter how good or sophisticated the analytical methods used to arrive at an enterprise's value are, they would not be precise except if the data on which they are built are sufficient and accurate. Two sets of data are needed for valuation of assets and companies. One group is the internal information derived from the enterprise itself and the other is external information concerning its surrounding business environment.

Miles (1984) offers a useful checklist of required information[1] for any enterprise to be valued or appraised. The internal information checklist includes precise information about the organization form, its legal form, its partners, their shares or its stock when applicable. It also includes information about the company products and services, their variety, their costs, their prices and their quality. It also includes information about marketing including product mix, major markets, sales volume, market share, growth potential, customers, geographical sales breakdown, competitors, promotion efforts, conducted market research and information about distributors.

Financial information is also very important. Information has to be gathered about the financial situation of the business, its sales, earnings, profits, available financial statements, their accuracy, cash and other current assets, existing claims, and forecasts of future performance. Some of the data collected should also be related to technical aspects and physical facilities and how many of them are owned or leased and what the terms are for the lease if any. Information about the management and personnel also needs to be collected. Organization charts, management attitudes (especially of those who are expected to stay), staff capabilities, experience and qualifications, staff pay structure and special benefits are also examples of the necessary information.

General information about the enterprise also needs to be gathered such as the date when the business was established, its present owner, capital, principal customers, suppliers, competitors, banks, employees and major accomplishments, in short everything about the firm. Necessary comparisons, scientific methods and statistical instruments are then employed to process these data to get necessary information for the evaluation of the assets and companies.

External information needed is generally about the environment in which an enterprise operates. This kind of information is especially important when the valuing committee is using techniques that are based on future benefits or gains. It includes information about the industry in which the enterprise operates, containing future outlook of the industry and information about other companies in the industry. If any other company in the industry was sold, information about the sale and company valuation would be useful.

[1] Only examples of the required information are included in this section.

Gathering information needed for valuation of public assets and companies in Egypt is usually conducted by an integrated team including an administrative accountant, a banker, a technical expert, an auditor, the marketing experts and others to collect data and study and analyze them. Then the team of workers presents the information needed for the valuation process whether it comes from inside or outside the company and whether it depends on data derived from the past or forecasts. The information should be presented in an appropriate form according to the purpose of valuation. Economists recommend that care should be taken not to harm the interest of the company or its competitive position by collecting or preparing such information. Whether the analyst is an independent practitioner or works for the selling or buying company in a bank or a consulting institution or a Government accountant working for the Central Auditing Organization, he / she should bear this principle in mind so that company representatives would cooperate with him / her (Hendy, 1997).

However, in many cases of SOE valuation this stage is surrounded by difficulties. The main reason for this is that internal information does not reflect the true financial situation of the company. This could be due to disguised subsidies, bad debts that appear on the credit side of the balance sheet or even subsidies that will cease to exist upon transfer to the private sector. Another problem is that public organizations in Egypt base their accounts on monetary basis. Many modifications, therefore, have to be made before valuation.

External information needed for valuation is also difficult in many cases. Many inter-related factors have to be taken into consideration and it is nearly impossible to predict market trends in the future. It is also difficult to predict the expected course of future interest rates, which naturally affects the present value of any future income.

## 9.5 Pricing Mechanisms

Prices generated by the different valuation methods are only guidelines that the seller and buyer should keep in mind when negotiating or finalizing a sale. The pricing mechanisms used to implement the sale play an important role in determining the final selling price. The most appropriate mechanism differs in each case according to the country, company, its activity and the different circumstances of each case.

In the case of public offering, the most two common methods (Vuylsteke, 1988) are the fixed price and the tender price method. The fixed price method means determining a fixed price for the share prior to offering for and implementing the sale at that price. The number of shares sold to each applying party is then scaled down in proportion to total applications.

The main advantage of using this method is that the small investor is thus encouraged to purchase the shares serving the objective of widening the ownership base. The price is also totally controlled by the Government. However, if the share price rises right after the sale, the Government could be accused of selling too low. On the other hand if it falls, the Government could be accused of over-pricing the share. This method is more appropriate in most cases. Even if the investors are allowed to make capital gains, this encourages investments in stock and activates the stock market

In the case of the tender price method the implementation price is the striking price representing the balance between tenders made at different prices and the number of shares available. All those that have tendered above the striking price receive shares at the striking price, while the others don't.

Although this method protects the state from undue criticism and guarantees the highest share price possible within the market circumstances, it is inappropriate when widespread share ownership is sought (too risky for small investors). It also does not allow for the introduction of special incentives such as discounts to encourage purchases by employees. This method is appropriate when the concerned enterprise is unique with a difficulty of setting its price.

The Egyptian method of pricing share offering is rather a combination of the two methods applied with an inclination towards the fixed price method. A fixed price is first determined and then the share price is allowed to fluctuate within a 5% range of increase or decrease according to the market supply and demand forces. The implementation price is the price at which the maximum number of shares demanded and offered meet. This method bears the advantages of a fixed price system and yet allows for some market influence.

Pricing mechanisms used in private sales whether of shares or assets mainly vary between auctions and competitive bidding (Vuylsteke, 1988). Both methods aim at determining the unit at present market value. Governments usually set a floor price prior to calling for bids considering it an indicative price that they should not go below. After receiving the bid the unit is sold to whoever pays more. In Egypt both methods have been applied as alternatives depending on the circumstances.

## 9.6 Different Methods of Valuation

Whether valuation is to determine value of shares for public offering or aiming to sell the unit to an anchor investor, a fair value that the buyer and seller consent to has to be reached. Both parties usually use several methods of valuation in order to reach the real value of the enterprise. These methods could be used separately or in combination. Some of these methods could also be used only as reference values by which the final price is adjusted or only as a standing point in negotiations. This section presents a short account of some of the methods that could be used in practice. The next section will illustrate which of these methods are applied in the Egyptian context.

There are two main basic approaches in valuation. One approach depends on the projection of income or cash flows and the other depends on asset valuation. Income based methods assume that when a buyer makes a purchase, he is buying future gains. Therefore he would be ready to pay a maximum of the present value of these future returns (the P/E multiple methods). Other methods assume that he will have to pay back a loan made for the purchase through the expected cash flow (ability to pay method). Some methods assume that the purchase is made for a long time, while in the other methods it is assumed that the purchaser will only hold it temporarily (discounted cash flow method).

Asset valuation based methods usually focus on the actual value of the assets. This could be the historical net value (in the accounting method), or the real market value that could include tangible assets or non-tangible assets (excess earning method). The following is a list of the most commonly used valuation methods (see Smith, 1988, Horn, 1990 and Stewart, 1991:

- Ability-to-pay method.
- Discounted cash flow method.
- Capitalization of income stream method.

- Excess earning method.
- Economic value of assets method.
- Comparable sales method.
- Price/earnings ratio method ("Multiple" of earnings method).
- Replacement Cost Approach.
- The Economic Value Added (EVA) method.
- A group of methods that basically depend on developing certain multiples that reflect the enterprise, industry and the market in general and Price/ common equity, Price Cash flow and Price/ Sales.

## 9.7 Factors Affecting Valuation of Shares

### 9.7.1 General

Many factors (Vuylsteke, 1988) may affect valuation of PEs or PE assets. Some of these factors are related to investors while others are related to the company and the surrounding market in general. The company's objective is to maximize share profitability, "aggrandizement". The main factors that have to be taken into account in doing so are the possible future gains, time, the changing money value and the risks involved. Another factor that has to be taken into consideration is that the value of shares is determined in the market.

Availability of financial resources and the desire to buy are key determinants among buyers. Another factor affecting valuation is the profit record of the company and the extent to which investors think they could improve company performance and profitability. Also the amounts needed for additional investment to develop the company or restructure it have their importance.

Government objectives also influence the value of a company. They may result in various discounts and price decreases serving certain objectives, e.g. targeted widespread ownership or employee buy-outs might decrease prices substantially. In some cases Governments gave away shares for political or social reasons.

Choice of the privatization technique also affects the value and price. Public floatation might give a better price than a private sale, but a private sale could be preferred due to specific circumstances of the company. In another case prices of public flotation might be decreased to ensure sale of all shares. Another price determinant is the general business environment. If the market is growing, prices increase. If the economy was going through a recession, prices tend to decrease.

### 9.7.2 Variables Introduced by Privatization

Since privatization causes changes in the legal form and ownership of public enterprises, it has resulted in increasing interest in valuation. Whether the unit to be divested is liquidated, sold as a going concern or partially or wholly offered through shares in the stock market, both the seller and buyers need to perform valuation.

Privatization is also expected to cause a drastic change in a PE's objectives and practices. This change will be accompanied by a change in the management's approach to many issues including the value of the company.

Under privatization the new investors will possess a quota in the company's capital shares. Since the purchase of shares is a purchase of future returns the distribution policy has its impact on the share's market value. If the majority of the targeted shareholders are small investors who depend on distributions for a living, the rate of distributable profits has its effect on the share's attraction, and therefore on its price[2]. Distribution acquires more importance when the rate of taxation on capital profits is larger than that on distribution (Hendy, 1997).

If the company decides to make distribution in the form of shares, it has to realize that this procedure would have a reverse effect on the share's market value unless it is accompanied with some encouraging financial indicators of the company's future which, in turn, depends on available investment opportunities. Distribution in the form of shares is in fact a method for holding back profits.

The individual investor's ownership of part of the company's capital shares gives them the right to vote in the general assembly. This means that some proposals made by the management may be met with opposition by the general assembly.

[2]Lorie, Dodd and Kimpton, impton, that the dividend distribution policy has no effect on the share market price, contradict this theory (See Lorie, James H., Peter Dodd and Mary Kimpton, The Stock Market Theories and Evidence, Richard D. Irwin, Inc., Illinois, USA, 1985,p. 94.

However, generally a great number of holders of ordinary shares do not practice their voting rights in an effective way[3].

From the point of view of the company, the ordinary shares represent a source of finance. Besides, the company is not legally bound to make a distribution even in the years when it makes profits. This is in addition to the fact that the issuing of more ordinary shares would lead to a decrease in the proportion of borrowed money in the capital structure and an increase in the volume of the company's borrowing capacity. All these new factors affect the attractiveness of the company share and hence its price in the market.

## 9.8 Valuation from the Investor's Point of View

Another aspect that has to be taken into consideration is how the private buyer sees the purchase[4]. Although the Government's objective is to maximize the sale proceeds, there is always a limitation to what investors *could* or *would* actually pay in the purchase. In anchor sales the price an investor would pay must be from his point of view less than the returns he expects from the specific purchase. He also bears in mind that there are many restrictions and limitations to the alterations he can make in the company. The limitations could be related to space, facilities or human aspects. A major GOE condition in Al-Ahram Beverage sale was that all the workers of the company are kept with their full previous pension and insurance rights (field work in Al-Ahram Beverage Company). Limitations could also be due to inability to change management or inflexibility of work procedures that had been going on for very long. Many investors (especially international investors) also consider the Egyptian market a high-risk market. All these factors have a negative impact on the amount of money a serious investor is ready to pay for a purchase.

Investors who choose to invest in the stock market also compare between what they pay and what they expect to earn. Whether future earnings are in the form of distributed dividends, retained earnings or premium in share prices the investor

[3]What actually happens in voting is that the share bearer gives proxy to a member of the board of directors to vote on his behalf. Such a procedure deprives the investor of his direct effect on the management of the company.

[4]Several interviews with different businessmen (as prospective investors) were made to discuss their acceptance of investing in SOEs and different problems of valuation.

expects gains. Here speculation plays a great role. Investors (especially small ones with limited liquidity) try to make investments from which they gain the highest returns in the shortest term. They would definitely respond positively to share price decreases by the Government (several shares were offered at lower prices to activate the Stock Exchange Market) from which they would definitely make quick capital gains.

After the fall in share prices in Feb. 1997, many small investors became hesitant to re-invest in the Stock Market. This was directly reflected in volume of activity causing further decrease in prices. Many of those investors still retain their stock hoping for another rise in prices such as that in 1996.

## 9.9 Stock Valuation in Egypt

This section focuses on share valuation procedures of Egyptian PE stock. The main aim is to identify whether valuation represents an obstacle to privatization implementation. The information included is based on interviews with Stock Market personnel, brokerage companies managers and representatives of the pricing committee. Two meetings have been also attended where the President of the Capital Market Authority clarified share prices determination and discussed specific share flotation to brokerage company representatives.

### 9.9.1 Who is in Charge?

Pricing of shares in Egypt is undertaken by a specialized Share Pricing Committee. Members of this committee include representatives from the Central Auditing Agency, the Stock Market, the Capital Market Authority, the holding company and a professional consultancy office. The committee determines the share price based on the HC's valuation of the AC share price, the balance sheet, financial reports and the auditor's report for the last three years of operations. After the price is determined, according to the company and market circumstances, the privatization committee gives the final approval. The determined price is considered an average price that could increase or decrease by a maximum of 5% (price ceiling) according to supply and demand conditions in the market.

### 9.9.2 Valuation Methods Used by the Committee

The major method (Chairman of the Stock Market Speech, 5th December,1996) of valuation used by the pricing committee is the Average Price/ Earning Ratio (P/E). This ratio mainly depends on average performance and hence earnings per share of different companies. It is determined on a daily basis according to profitability in the different sectors. It is then published in major newspapers (see section 9.5.6).

First the P/E ratio is determined for individual companies, then averages are calculated for the different sectors and then a market average is calculated. The Egyptian average reached a peak of 13 at the beginning of 1997 (Al Borsa, 24th January, 1997) but decreased to an average of 9.5 in 1998. The P/E ratio on which the initial price of the share is determined is included in advertisements for share flotation to ensure transparency. A recent share flotation of "The Egyptian Construction Compan" was announced in May 1998 (Al-Ahram, 22nd May, 1998) and calculated the price according to a P/E value of 9.6 in 1996/97 and 9.2 in 1997/98.

After determining the initial price using the P/E multiple method, the pricing committee adjusts the share price, taking several other factors into consideration such as risks involved, company activity, company market share, its assets, and historical performance to set the most appropriate price. Sometimes the pricing committee sets a certain expensive asset or plant aside and does not include it in the sale.

### 9.9.3 GOE Precautions

The GOE takes two major precautions to make sure that the value of the company shares is not under or over valued. The first one is using the reference price method rather than the tender method for share price determination. This necessitates using a pre-determined reference price as mentioned in the previous section and not leaving it completely to market forces. The second thing is the price ceiling.

The main function of the imposed 5% price increase ceiling is to make sure that the company share value stays within the range of the predetermined range. One of the proposed ideas to develop the Stock Market was canceling the upper ceiling of prices, while retaining the lower one in order to maximize GOE earnings. The decision was actually made during 1996 on a trial basis. It was soon cancelled.

The Alexandria Commercial and Maritime Bank was one of the offerings that were made according to this system. The share was offered at a reference value of LE 150. After the supply and demand orders were processed, the implementation price (where the maximum amounts of demand and supplies met) was determined at LE 300. This price was way beyond the value of the share. Although many of the brokers had made orders for around that price (to make sure they receive an allocation), most of them had expected a lower implementation price (they would pay at the implementation price). Many of the brokers did not have enough liquidity to pay the sale value. Others had problems with customers who refused to receive the expensive shares.

### 9.9.4 Procedures After Initial Price is Determined

Once a share price is determined an advertisement is published in major newspapers. Five days are left for broker companies to receive orders from customers. Two days are then allowed for brokers to register their orders in the stock market. The implementation day is then determined and orders are entered into the computer system. Brokers enter demanded quantities at prices that do not exceed a 5% increase or decrease from the initial price or they are not accepted.

### 9.9.5 Pricing Mechanism

The final selling price is set according to the supply and demand forces with a 5% (+) or (-) ceiling. It is the price at which the maximum amount of demand meets the maximum amount of supply on the implementation day. The determined price is then announced as the implementation price (one price for all transactions). Only orders that carry the same price or more are implemented for that price. Orders that were made for less than the implementation price are ignored. Quantities are then allocated to bidders in proportion to the quantities they had ordered.

## 9.9.6 Comments

As evident from the above demonstration of the stock pricing mechanism, modern valuation methods and mechanisms are applied in valuing SOE stock. Yet, the Government still interferes to a large extent. Although this contradicts a market-oriented approach, the researcher considers it generally favourable to the privatization process in the Egyptian setting, at present. The main reason behind this is that the Egyptian Stock Market in its modern active form is fairly new to the Egyptian capital markets and could safely be considered to be in the development stage.

## 9.10 Valuation of Units for Sale to Major Investors

In Egypt auctions and competitive bidding have been applied alternatively to value SOEs and SOE assets for private sales. Auctions have generally been used to sell PE assets while competitive bidding is usually used in anchor investor sales (selling to one or a few major investors). Liquidated companies are sold as assets according to their market values using competitive bidding or auction procedures. In *both cases several committees are formed* to perform the sale. Selling committees, pricing committees, and offer evaluation committees are examples of these committees. Several specialized offices are also asked to perform valuation of the offered unit. Informed by their valuation the pricing committee arrives at the expected price.

However, determining the right price for such sales is one of the most challenging obstacles to privatization. Sales to anchor investors, which are considered a better selling method for many PE units, are delayed for months for fear that the pricing committee has not reached an appropriate price. A Government official mentioned that there are times when as many as *eight* meetings are required for final approval of a single valuation (IBTCI, January-June, 1997). Transparency has also proved to be a problem in many cases.

Al-Ahram Beverage case is one of the ten cases that had been privatized through an anchor investor sale. The sale took over a year to be finalized. One of the main problems that faced the sale was the many legal and technical issues the sale had to go through (on behalf of the GOE) to ensure that the selling price was adequate.

Another problem was the lack of transparency represented by the ambiguity of the selling conditions, which were changed several times during the negotiating period and many conditions were added (field work in Al-Ahram Beverage Company).

Fear of under-pricing or of being accused of doing so, should be faced by more transparency and publicity of the intended sale and of the actual procedures and steps that take place. It could also be overcome by different precautions that allow for getting the best deal without necessarily complicating the procedures. An example of such precautions could be receiving bids for one week after final price is announced. If serious bids that offer better conditions are received, an open auction can be held within two weeks of announcing the final price. Serious bidders would be required to place large insurance amounts to enter the auction and the best bidder with the best conditions would make the purchase.

A case study is included as section 9.13 to this chapter to practically demonstrate the pricing methods and mechanisms used in the sale of an operating going concern to an anchor investor (the Sheraton Sale Case Study). The case shows the difficulties encountered in valuation of such a case.

## *9.11 Difficulties of Valuing a Publicly owned Enterprise*

The following points could summarize difficulties of public enterprise valuation in the researcher's opinion[5]:

1. There is always fear of underestimating the value of a public enterprise or at least being accused of doing so. Hence, Government representatives tend to overvalue companies creating a problem in finding buyers.
2. Selling procedures and necessary approvals consume a long time.
3. Many inter-related factors have to be taken into account in the valuation process e.g. labour issues, possibility of management change...etc.
4. Accounting records do not normally reflect the true financial status of the public enterprises.

[5]These reasons were deduced from the presented literature survey and the different interviews with representatives of the pricing committee, brokers and officials at the Ministry of Finance.

5. The existing commitments and entangled situations (e.g. preferential advantages or monopoly positions or customs protection) have their effect on the company's value.
6. Public organizations in Egypt base their accounts on a monetary basis. Many modifications, therefore, have to be made before valuation.
7. It is difficult to determine the company's future income capacity and consequently its ability to make profits in the future due to external factors and the uncertainty of market trends.
8. It is difficult to predict the expected course of future interest rates which naturally affects the present value of any future income.
9. Estimating intangible assets is not always easy.
10. No adequate explanation of the different methods of valuation used has been publicly provided. Consequently, many experts and the public have doubts regarding their adequacy, which causes reluctance to privatize on the part of the Government. More marketing is needed to facilitate the transfer.

Most of these problems either affect desirability of going on with the sale amongst officials, or feasibility of the sale due to the many complications encountered in the valuation process. This is starkly evident in sales made to anchor investors. It is worth mentioning here that only 4 out of 33 planned anchor sales took place during 1997 and that till the end of 1997 only ten took place.

## 9.12 Managers' Attitudes on Some Valuation Issues

In this section top managers' attitudes concerning parties that should perform valuation of SOEs (prior to sale), different methods of valuation and the expected accuracy of the valuation are briefly presented. The reason why only top managers were asked their views on this topic was that they are usually more involved in the valuation process.

### 9.12.1 Managers' Views Concerning who should Perform the Valuation of SOEs Prior to Sale (Quest. A Q 24)

In most cases of valuation of SOEs there is usually a debate about who should be responsible for estimating the value of Public Enterprises prior to sale. The debate is usually about whether to limit the valuation committee to the managers from inside the company, "*internal parties*", or to allow professional, " *external parties*", to perform the valuation process. While many of the managers feel that internal parties are more aware of company specifics, many outsiders feel that being involved managers usually tend to over-value their companies. Also, in many cases managers lack the expertise necessary for the valuation process.

The following open-ended question aimed to find out the managers' attitudes concerning who should perform the valuation process:

*Who should estimate the value of Public Enterprises?*

*A) Internal parties (please specify)*

*B) External parties (please specify)*

Among the different answers of the managers were:

*A- Internal parties*

1- *A committee made up of company managers.*
2- *Board of advisors.*

*B- External Parties*

3- *Consultantcy offices and Egyptian experts.*
4- *Banks, especially National Investment Bank.*
5- *Central Accounting Agency.*
6- *Holding company representatives.*
7- *University professors.*
8- *Business public office.*
9- *Representatives of stockholders and depositors.*
10- *Retired public sector managers who have a lot of experience.*
11- *Stock market representatives*
12- *Office representing buyers.*
13- *Representatives of Ministry of Finance.*

The most frequent answers are summarized and tabulated in table 10.1 where the numbers in the top row refer to the statements above.

**Table 9.1: Managers' Opinions Concerning who Should Perform the Valuation Process**

| Response → / Mgmt. Classification ↓ | 1 | 2 | 3 | 4 | 5 | 6 | 8 | 13 | 0 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | 26.4 | 5.7 | 45.3 | 11.3 | 3.8 | 1.9 | 1.9 | 1.9 | 1.9 | 100.0 | 113.0*** | 9.29 D.F=8 NS |
| Industrial | 30.0 | 10.0 | 20.0 | 20.0 | 10.0 | 0.0 | 10.0 | 0.0 | 0.0 | 100.0 | 2.12 NS | |
| Non- In. | 25.6 | 4.7 | 51.2 | 9.3 | 2.3 | 2.3 | 0.0 | 2.3 | 2.3 | 100.0 | 68.74*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

One can note that:

- The most popular choice was that the valuation process should be performed by "*external consultant offices and Egyptian experts.*"
- The second most frequent response (19.1%) whether in industrial (20%) or non-industrial companies (18.9 %) was that "*the valuation process should take place internally, by a committee made up of company managers.*"
- Another frequent answer was "*banks especially the National Bank of Egypt.*"
- The Chi-square tests show no significant differences within the group of managers in industrial companies from what one would expect on a chance basis. Yet, there has been a significant difference within the group of managers from non-industrial companies from what one would expect on a chance basis. There is no significant difference between the group of managers from industrial companies and those from non-industrial companies.

## 9.12.2 Managers' Attitudes about the Most Appropriate Methods that Could be Used in Valuation (Quest. A Q23)

Managers were asked to determine the best valuation method from their points of view. They were asked to indicate the method most appropriate for their own company and for Public Enterprises in general, if different.

Among the different answers managers indicated are:

*1- Actual asset valuation according to market prices.*

*2- Book value or book value multiplied by a certain mean.*

*3- Market value of company after taking into consideration "good will".*

*4- Discounted value.*

*5- Return on investment.*

*6- There is no accurate method.*

*7- Any method on condition that reporters and newspapers don't interfere.*

*8- Case by case bases.*

*9- Stock Exchange market should determine price.*

*10- Number of workers and productivity should be taken into consideration when determining selling price. Usually they will have a negative effect on selling price.*

The most frequent answers are summarized and tabulated in table 10.2 where the numbers in the top row refer to the statements above.

**Table 9.2: Managers' Opinions Concerning the Most Appropriate Method of Valuation from their Points of View**

| Response → / Mgmt. Classification ↓ | 1 | 2 | 3 | 4 | 5 | 7 | 8 | 10 | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|---|---|
| All Managers | 57.4 | 2.1 | 19.1 | 4.3 | 8.5 | 2.1 | 4.3 | 2.1 | 100.0 | 161.0 | 8.91 |
| *Industrial* | 50.0 | 0.0 | 4.3 | 0.0 | 30.0 | 0.0 | 0.0 | 0.0 | 100.0 | 11.48 NS | D.F=7 NS |
| Non- In. | 59.5 | 2.7 | 0.0 | 5.4 | 2.7 | 2.7 | 5.4 | 2.7 | 100.0 | 73.12*** | |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

The majority of managers (57.4%) whether in industrial (50 %) or non-industrial companies (59.5%) thought the most appropriate method of valuation is valuation according to real market value of SOEs. The second most frequent response (19.1%) whether in industrial (20%) or non-industrial companies (18.9 %) was the market price but taking into consideration the value of "good will".

The Chi-square tests show no significant difference within the group of managers in industrial companies from what one would expect on a chance basis.

Yet, there has been a significant difference within the group of managers from non-industrial companies from what one would expect on a chance basis. There is no significant difference between the group of managers from industrial companies and those from non-industrial companies.

### 9.12.3 Managers' Views Concerning Expected Accuracy of Valuation of SOEs (Quest. A Q25)

Managers were asked:

*How accurate do you expect the valuation would be?*

*A) 100%* *B) 80%* *C) 50%*

*D) Less than 50%* *E) Impossible to predict* *F) Impossible to be accurate.*

The answers are summarized and tabulated in the following table where the letters in the top row refer to one of the previous options.

**Table 9.3: Managers' Views Concerning Expected Accuracy of Valuation of SOEs**

| Response → / Mgmt. Classification ↓ | A | B | C | D | E | F | Total | $X_1^2$ | $X_2^2$ |
|---|---|---|---|---|---|---|---|---|---|
| All Managers | 8.8 | 57.4 | 16.2 | 4.4 | 8.8 | 4.4 | 100.0 | 110.6*** | 3.34 |
| Indust-rail | 7.1 | 71.4 | 14.3 | 0.0 | 0.0 | 7.1 | 100.0 | 25.91*** | D.F=5 |
| Non- In. | 9.3 | 53.7 | 16.7 | 5.6 | 11.1 | 3.7 | 100.0 | 52.36*** | NS |

(1) All figures are expressed as percentages of row total.
(2) *Significant at 0.05 level of significance
** Significant at 0.01 level of significance
*** Significant at 0.001 level of significance
NS Not significant

One can note that:

- Most managers (57.4 %) whether in industrial (71.4 %) or non-industrial companies (53.7 %) thought the expected rate of accuracy will be around 80%.
- The second most frequent response (16.2%) whether in industrial (14.3 %) or non-industrial companies (16.7 %) was an accuracy rate of around 50%.
- Only 8.8% of the senior managers expected an accuracy rate of 100%.
- These answers reflect one of the major problems in valuation, which is difficulty of reaching a 100% rate of accuracy.

- The Chi-square tests show that the distribution of all the managers on this issue is different from that which could be expected on a chance basis. The differences related to level of management and whether the company is industrial or non-industrial have proved to be statistically insignificant in all cases.

## 9.13 A Case Study on Valuation: The Sheraton Hotel Sale

The following case is a detailed analysis of the steps and procedures undertaken to sell Cairo Sheraton Hotel, Tower and Casino. The case demonstrates which methods of valuation were used by the GOE and what the pricing mechanisms for anchor sales usually are. The main purpose is to investigate whether valuation of sales to anchor investors is a problem in any way hindering smooth implementation of privatization. Data were obtained from interviews, record examinations and review of published documents *(White Book).*

### 9.13.1 Hotel Background

1. The Cairo Sheraton Hotel is one of the major hotels in Cairo.
2. A brief description of the Hotel

   The Hotel consists of :

   - The old building (*Nefrtiti*)

     27 stories with 343 units operating since the mid sixties
   - The new annex (*Cleopatra*)

     27 stories with 317 rooms operating since 1990
   - The total number of rooms is 660
   - The old and new buildings are connected on the first floor forming the main lobby
3. The managing Company is Sheraton International Company. The management contract was renewed on 1/7/1989 for 20 years.
4. The owning Company: The Egyptian General Company for Tourism and Hotels (EGOTH).
5. The owner's share is 84% of the total operating profits.

6. The hotel has a very good location (between El Galaa square and El Giza Street facing the Nile's west bank).
7. The total area of the hotel is 5451.05 square metres.
8. The hotel contains a group of different restaurants and cafeterias, a region for boutiques, reception offices, business centres, swimming pools, together with a group of suites and garage (basement) with 300 car capacity and a cinema hall seating 280 persons.
9. According to the endorsed Balance Sheet on 30/6/1993

| | |
|---|---|
| • The total cost of assets | LE 119.547 million |
| • Enterprises under execution | LE 0.180 million |
| **Total** | **LE 119.727 million** |

10. EGOTH share of income and ownership burden

    The following is ***EGOTH*** share of the hotel's net profits during the period from 1/7/90 until 31/12/93 (3.5 years).

**Table 9.4: EGOTH Share of Income and Ownership Burden**

*In thousands Egyptian Pounds*

| Period | EGOTH Share in the hotel's total operating profits | Ownership burden | | EGOTH Net share of profits |
|---|---|---|---|---|
| | | Depreciation | Real Estate taxes | |
| 90\ 91 | 23150 | 3158 | 38 | 19954 |
| 91\ 92 | 44849 | 3374 | 38 | 41437 |
| 92\ 93 | 42403 | 3501 | 38 | 38864 |
| Until 31/12/93 | 21461 | 1751 | 19 | 19691 |
| **Total** | **131863** | **11784** | **133** | **119946** |
| The Yearly Average | 37675 | 3366 | 38 | 34270 |

*Source: EGOTH Financial Documents*

***From the above data one can reach the following conclusion:***

1. ***EGOTH*** share in the hotel's total profits for the period from 1/7/90 until 31/12/93 is LE131.863 million.
2. ***EGOTH*** net share in the hotel's total profits for the period from 1/7/90 until 31/12/93 i.e after discounting ownership burdens is LE 119.946 million.
3. ***EGOTH*** average share in the hotel's total profits = 131863 / 3.5 = LE 37.675 million

4. ***EGOTH*** average share in the hotel's net profits after discounting ownership burdens

The net value = 119946 / 3.5 = LE 34027 million

**It is noteworthy that the EGOTH share for three and a half years was calculated to represent the hotel's extension related to the new annex and the hotel's full operation (1990 to mid 1993).**

### 9.13.2 The Detailed Procedures

The selling procedures were implemented in two main stages. In the first stage the sale was not finalized due to several reasons. The second stage, however, was terminated by implementing the sale.

**□ The First Stage**

Within the general state policy of expanding the base of ownership, the Holding Tourism Company received on 6/2/1993 a letter from the Public Enterprise Ministry. The letter referred to the sale of units chosen to start with, which was to be announced in the newspapers. Among these units was the Cairo Sheraton Hotel owned by *EGOTH*. The letter also mentioned that Misr Iran Development Bank was chosen to help the holding and affiliated companies in carrying out the sale against flat fees ranging from 1% to 2% of the sale proceeds.

*The Bank Role*

1. Helping the company in marketing the asset offered for sale.
2. Setting the bases for selecting the tenderers.
3. Offering the sale documents.
4. Preparing the principles of the evaluation of the offer.
5. Helping the companies in negotiating and preparing the sale contract.

According to the letter from Misr Iran Bank on 11/2/1993 and the proposals included therein, together with the meetings which followed with the bank and the affiliated company, an agreement was reached with the bank on the necessary steps to finalize the promotion and the sale transaction according to a time table.

On 18th Feb. 1993 an extraordinary meeting of the General Assembly of ***EGOTH*** was held. It endorsed the principle of selling the units included within the Government's programme for the years 91/92 and 92/93, Cairo Sheraton Hotel included. It also agreed on the re-valuation of these units which had been previously valued by "***Coopes & Lybrand"*** and their associates. The re-valuation was to be made by "***BECKTEL Group."***

The valuation of Sheraton according to "***Coopes & Lybrand"*** amounted to LE 347 million on the basis of the "discounted cash flow" method, LE.296 million according to market value and LE 354 million according to the replacement value.

An advertisement of the sale was published as part of a promotion programme in the Egyptian newspapers, namely Al-Ahram, Al-Akhbar and Al-Gamhouria, and Arab Newspapers in Riyad, Saudi Arabia, the Kuwaiti Public Opinion, Al-Ittihad in the U.A.E, and the World Today in Saudi Arabia. The advertisement published in Arabic and English was intended to acquaint investors with the hotel so that they can submit their offers.

After the decree to merge the Holding Tourism Company into the Holding Housing Company, and continuing what had been started, the following steps were taken:

- On 25/6/93 the hotel's valuation prepared by "***BECKTEL Group"*** was studied and discussed with the holding and affiliated companies.
- Misr Iran Bank included within the list of consultancy offices and banks of the technical bureau, was chosen to supply technical help. The bank chose ***Solomon Brothers*** as its financial counselor. The contract for supplying technical services was signed with the bank on 19/6/1993.
- A memorandum including full full ation about the hotel, the sale and bidding documents was prepared in coordination with the holding and affiliated companies and Misr Iran Bank.

- The sale and its conditions were advertised in local and international newspapers with particular reference to the fact that the deadline for bidding was 4/10/1993.
- On the date set for receiving the bids[6] the following companies participated.

1. Al Kharafi Group for Construction (*excluded for not presenting a letter of guarantee*).
2. The Arab International Company for joint Investment (**$126 million**).
3. Saudi Egyptian Group for Investment and Development (**$81million**).
4. Board Guest (*excluded for not presenting a letter of guarantee*).

- On 3/10/1993 ***EGOTH*** prepared the basic price after studying the different valuations and adjusting the amount according to several different factors related to valuation. The determined basic price was deposited in a sealed envelope in the holding company's safe. It amounted to $179 million.
- On 5/10/1993 the technical and financial committee of evaluation started evaluation of the bids. It marked the following results:

  **First**: The number of bids (offers) for buying the hotel was comparatively small as a result of the circumstances associated with tourism and the impact of extremist acts. The number does not reflect the real demand on the purchase whether in local or international markets.

  **Second**: The offered prices were very low compared with the basic price (set by ***EGOTH*** and ***BECKTEL***).

- The selling procedures were discontinued, and the banks were advised accordingly.

### ❑ The Second Stage

In light of the serious desire for carrying out the sale and implementing the Government's programme, it was decided to re-offer Cairo Sheraton Hotel for sale and have the event advertised through ***EGOTH*** according to the following procedures:

[6] This information is derived from the committees, which opened the envelopes.

- Review of the basic price in light of the results of the first stage. This was agreed upon by the holding and affiliated companies and the Minister of Public Enterprise Sector. It was also decided to take into account the valuation made by the consultancy offices. The basic price, which the owning company determined, was $150 million.
- *BECKTEL* Group had valued the hotel at an amount ranging between $116 million and $134 million, using four methods for deciding the hotel's valuation limits. Following were the methods and results reached:

**Table 9.5: Different Values According to Different Methods Used**

| Method | Million US Dollars | Million Egyptian Pounds |
|---|---|---|
| The cost of replacement | 545.6 | 731 |
| Replacement after depreciation | 110 | 365.4 |
| Discounted Cash Flow | 124 | 446.9 |
| Comparable Sales | 108 | 360 |

- The memorandum of the full details about the hotel and the book of terms and specifications for selling the hotel were prepared.
- An advertisement of the sale was published in the following newspapers:

  *Al Ahram – Al Ahram Weekly (the International Edition) – Al Akbar El Youm- Al Gamhouria – Al Siassa (in Kuwait).*
- The following parties received the book of terms and specification.

1. The Arab Investment company for Touristic Development on 18/1/94.
2. The International Company for Investment and Development on 18/1/94.
3. Kuwait Real Estate Counsultancy Group on 18/1/94.
4. Saudi Egyptian Company for Touristic Development on 18/1/94.
5. AKA Company for contracts and Real State Consultancy on 19/1/94.
6. Yasmina Marketing Company on 19/1/94.
7. Sally Group on 20/1/94.
8. Emad Ahmed Mustafa Mokhtar on 24/1/94.
9. El Kharafi Company for Construction and Contracts on 30/1/94.

10. Arab African Bank on 30/1/94.

- On the date set for opening the envelopes, one bid only was presented by the Arab company for Touristic Development in the presence of the company's Chairman Mr.Ahmed El Hadeery.
- On 31\1\1994 the committee for inspecting and evaluating the bids met. It reviewed the documents. The offer could be summarized as follows:

| | |
|---|---|
| A-The bids value | $ 126 million |
| B-Method of payment | |
| • Preliminary letter of guarantee | $ 500 thousand |
| • Final letter of guarantee (company is advised that the contract tent to it) | $ 62.5 million |
| • Cash (as soon as transfer of ownership procedures are finalized according to the way the seller decides) | $ 63.0 million |

- The committee of inspection and evaluation reached the following conclusions:

  1-The purchase price offered by the company is not proportionate with the value of the hotel and its returns and with the basic price set by ***BECKTEL*** or the owning company.

  2-The 50% down payment at signing the preliminary contract is to be in cash instead of by a letter of guarantee. 40% is to be paid when the buyer receives the hotel. The rest is to be deposited in an "Escrow Account" in favor of ***EGOTH*** to be transferred to its free account at the time of registration or after one year from the date of the preliminary selling contract, whichever is nearer provided that ***EGOTH*** should submit documents of ownership on a convenient date to be agreed upon.

  3-The committee suggested that the negotiating committee is to be given the freedom to amend the method and conditions of payment so that they can best serve the interests of ***EGOTH***.

- A negotiating committee was set up under the presidency of the Chairman of the holding company. Members of the committee were:

1- A member of the board of directors responsible for Touristic activities[7].

2- A member of the broad of directors of the holding company[8].

3- Chairman of ***EGOTH***[9].

4- The managing director of ***EGOTH***[10].

- The negotiating committee held several meetings with representatives of the company offering to purchase the hotel, namely the Touristic Investment Company. Finally, they reached an agreement. As a result of the efforts exerted on the part of the buyer and the assistance of the Public Enterprise Minister, the purchasing company agreed to increase the hotel price by $21 million, from $126 million to $ 147 million. The draft agreement of intent signed by the selling committee was sent to the buyer.
- The member responsible for touristic activities prepared a study of the valuation of Cairo Sheraton Hotel and Casino. It was submitted to an extraordinary General Assembly meeting of EGOTH on 19\4\1994. The study demonstrated the total and net returns for the investor according to the offered price of purchase, which was $147 million.
- The extraordinary general assembly of EGOTH meeting on 19\4\1994 agreed on the principle of selling Cairo Sheraton Hotel Tower and Casino at $147 million according to the draft agreement of intent submitted to them and which coped with privatization objectives in this stage, and offering 30% for public subscription during a certain period. It was also agreed not to affect a complete sale of the assets.
- The agreement can be summed up as follows:

  -The two parties undertake to establish a joint company according to Law 230 for 1989 with an authorized capital of $300 million and an issued capital of $150 million.

[7]Mr. Abd El Hamid Farghaly

[8]Mr. Abou Zaid Radwan

[9]Mr. Hamed Abdel Megid

[10]Mr. Adly Demerdash,

-A participation of 78% for the Arab Investment Company for Touristic Development which undertakes to offer 8% (out of the 78%) for Egyptian public subscription within 3 years from the date of establishment at the nominal value, unless the rights of the shareholders are higher according to a written certificate issued by the accounts controller.

-20% for ***EGOTH*** is to be offered for Egyptian public subscription within 3 years from the date of establishing the company.

-2% for the Holding Company for Housing, Tourism and Cinema to be also offered for Egyptian public subscription with the same conditions.

The extraordinary general assembly of EGOTH was held on 8\10\1994 to inspect the agreement of the founders of "The National Company for Tourism and Hotels" (a joint stock company under establishment). It agreed on the following:

- The endorsement of the agreement to establish the National Company for Tourism and Hotels, an Egyptian joint-stock company ( under establishment) signed on 19\9\1994 to be assigned the ownership of Cairo Sheraton Hotel, tower and casino for $147 million provided that the company's authorized capital should be $200 million and provided that subscription to issued capital should be as follows:
    1. EGOTH an amount of $30 million, i.e, 20% of the issued capital is to be offered to the Egyptian public within 3 years from the date when the company is established.
    2. The Holding Company for Hotels, Tourism and Cinema: an amount of L.E 83 million, i.e, 2% of the issued company to be offered to the Egyptian public within 3 years from the date of the company's establishment.
    3. The Arab Investment Company for Touristic Development: an amount of $117 million, i.e, 78% of the issued capital 8% of which to be offered to the Egyptian public within 3 years from the date of establishing the company.

❖ A work team was set up from members of the board of directors of the holding company and representatives or the holding company and representatives of *EGOTH*.

- The team was to negotiate with the management of the International Sheraton Overseas Company to obtain a final decision on the subject of transferring Sheraton Hotel management contract to the new company.
- The regional manager of Sheraton World Hotels (with which the Hotel has a management contract) was advised on the demand to get their acceptance to transfer the management of Cairo Sheraton Hotel to the new company the National Company for Tourism and Hotels (an Egyptian joint stock company under establishment), establishment of which was approved by the extraordinary general assembly of ***EGOTH*** on 8/12/1994.
- A letter was received from the Egyptian Embassy in Washington on 18/10/1994 to the effect that the manager of foreign relations of ITT Company which owns Sheraton Company advised that in compliance with the American Law the management of Sheraton World Company was keen on having the sale made in such a way that the Libyan capital should not have the upper hands i.e., not to exceed 50%.

Since it was understood that the management of Sheraton Overseas does not accept the transfer of the management contract unless the Libyan party owns less than 50% of the stock of the National Company for Tourism and Hotels so that it cannot have absolute majority in the management of the company, an extraordinary meeting of the general assembly of ***EGOTH*** was held on 20/4/1995 and agreed on the following:

1. Changing the name of the Arab Company for Touristic Development participating in the establishment of the company to the Arab Company for Touristic Enterprises.
2. Reducing the participation of the Arab Company for Touristic Enterprises to 70% instead of 78%.
3. Raising ***EGOTH*** participation to 28%, keeping the participation of the Holding Company for Housing, Tourism and Cinema as it was at 2%.

4. The participation in the Arab International Company for Joint Investment amounted to 48.8%, while the Egyptian party owned 51.2%. The Arab Company for Joint Investments owned 100% of the capital of the Arab Company for Touristic Enterprises, which replaced the Arab Company for Touristic Development, the previous participant in the establishment.

The representatives of the two founders were asked to effect the necessary amendments and were supplied with all the approvals issued by the General Organization for Investment with regard to the above mentioned amendments which were approved by the extraordinary meeting of the general assembly of ***EGOTH*** on 2/5/95. The regional manager of Sheraton World Hotels was advised accordingly on 14/5/1995 to obtain an approval on transferring the contract to the joint company.

### 9.13.3 Researcher's Comments

1. The case reveals a few of the problems that could be encountered in the valuation process. It shows the long time and many procedures a sale to an anchor investor takes.
2. It also shows how different methods of valuation result in different results.
   A) The "discounted cash flows" method is dependent on the discount rate and assumptions on future developments, which differ from one offer to another.
   B) The replacement value varied because it depends on personal estimations. Further, each hotel had its specific circumstances and different factors that determine the cost of a room (the replacement value is used after discounting depreciation).
   C) The fair market value, which can be reached by the efficient selling of the asset in the market is also subjective depending on subjective estimation by experts and prospective buyers with some help from book value.
   D) The value of comparable sales of alternative enterprises varied because there are no completely identical cases. Each case has its own circumstances.

3. It is also evident how all the methods (with the exception of discounted cash flow) stress the assets side of the enterprise. The income generating capacity of the enterprise and its ability to make profits was not given due importance. Ability to make future returns would be the main criterion for valuation by the purchaser. The selling committee should have given this aspect more importance in determining value.
4. Also, some of the methods used were not very appropriate for the situation. The replacement method usually used for insurance purposes, was not very appropriate for finding the actual value of existing assets. It is also highly subjective.
5. However, it is the researchers' view that in the valuation of anchor sales, it is of utmost importance to use several valuation methods. Neither the "replacement method" nor the "discounted cash flow" methods are appropriate for valuation of anchor sale candidates. These methods are rather subjective and should only be used as indicators to help reach the most appropriate price. More reliance should be placed on income based methods that take into consideration that the company will continue in operation for a long period of time. Depending on several more objective methods will not only increase preciseness of the results, but also encourage those responsible to make their final decisions in a more relaxed mode of work and in a quicker manner .
6. The negotiating committee was able to increase the price of the sale. The offer price was raised from $126 million to the final selling price of $147 million. This shows the importance of the role of negotiations in determining the price in such sales.
7. There was a great difference in the basic price as set by the affiliated company and the consultancy offices which shows the exaggeration of the affiliated companies in valuing the assets they own. In many cases this tendency could result in difficulty of finding a keen purchaser who is ready to pay the price.
8. Officials in the pricing committee have stated that after the establishment of the company which bought the hotel and in light of the returns it was expected to get from Sheraton Hotel represented in the owner's share in the net operating profits and the net returns after discounting the ownership burden (depreciation, insurance, real estate taxes and the administrative charges of the company) the distributable surplus, and the distributed dividends and the coupons will be

determined. The machinery of the market will set the real value of the stock. If the valuation was exaggerated the share price will go down, and vice versa. This should also be kept in mind in the valuation process.

**Finally, the case demonstrates how valuation of sales to anchor investors takes place practically. It shows the difficulties encountered in the valuation process and how its procedures could be time consuming and complicated. The case also demonstrates the difficulty of reaching a precise valuation of SOEs in question and how officials tend to either postpone decisions or exaggerate in their valuation *to be on the safe side.* This completely agrees with survey results. If sales to anchor investors are to be more widely depended upon in the next stages of privatization, as announced by the Government, than valuation procedures ought to be reviewed and simplified.**

## 9.13 Conclusion

❖ **General**

- Valuation of assets and companies differs according to the different purposes and methods used.
- In the case of public offering there are two main methods, the fixed price and the tender price methods. Each method has some advantages and some disadvantages.
- Precise and clear information is essential for the valuation process. This information could be internal or external. It could be related to past performance or future predictions.
- There are many methods of valuation. They could either be used separately or combined. Some of them can merely be used as indicators. Among these methods are ability-to-pay method, the discounted cash flow method, the capitalization of income stream method, the excess earnings method, the economic value of assets method, the comparable sales methods and the price/earning ratio method. Using several methods of valuation not only increases precision of final price, but would also boost eagerness to finalize different deals instead of slowness out of fear of being blamed in the future for a low valuation.

- Many factors may affect valuation of PEs or PE assets. Some of these factors are related to investors while others are related to the company and the surrounding market in general. Many of these factors were initiated by the privatization policy.

❖ **In Egypt**

- Pricing for liquidation or of individual assets usually depends on market value. Competitive bidding and auctions are usually used.
- Valuation of ongoing concerns utilizing the different methods of valuation to reach a floor value. Competitive bidding or auctions usually determine the final price.
- Pricing of shares offerings is not completely left to the market. Prices are first determined by a pricing committee and then approved by the privatization committee. A 5% ceiling is then imposed, so as not to allow the price to increase or decrease by more than 5%. The implementation price is set at the point where the demand for and supply of shares are expected to be in balance. Only orders carrying the implementation price or more are executed at the implementation price.
- Valuation of public enterprises encounters many problems and could be considered one of the reasons behind slowness of implementation. The most important problem is fear of those in charge of under or over valuing an enterprise. Also the existing commitments, the entangled situations and the many inter-related factors that have to be taken into account in the valuation process increase its difficulty. Furthermore, the accounting records based on monetary bases need many modifications before the valuation process. Another problem is that accounting records do not reflect the true financial status of the company in many cases. There is also difficulty in determining the company's future income capacity or the future changes in the market in general, e.g. interest rates. Another important problem is the time consuming procedures that a sale has to go through.
- Most of these problems either affect the willingness of officials to go on with the sale, or feasibility of the sale due to the many complications encountered in the valuation process. This is more evident in sales made to anchor investors.

❖ **Managers' Views**

- While most of the senior managers thought that "external consultant offices and Egyptian experts" should perform the valuation process, others thought that an internal committee of managers would be sufficient.
- Most managers agreed that the most appropriate method of valuation was that based on the real market value of the SOE. A group of managers also stressed the importance of taking "goodwill" into consideration.
- Some of the managers had their doubts about the possible accuracy of the valuation methods that could be applied. The expected rate of accuracy of the valuation process, from the managers' point of view varied between 0% and 100%. However, most managers expected an accuracy rate of 80%.

❖ **Findings of Case Study Analysis**

The case study presented the valuation and sale procedures of one of the biggest ongoing projects that have been sold to anchor investors as part of the privatization process. It demonstrates the valuation procedures that took place, the practical difficulties encountered in the valuation process and how procedures *could* be time consuming and complicated. The case clearly demonstrates how officials tend either to postpone decisions or to exaggerate the value *to be on the safe side*. Both types of behaviour could be major obstacles for smooth implementation. The case study supports managers' views obtained from survey results, indicating that 100% accuracy of valuation of SOEs is very hard to realize in practice and highlights the difficulties and problems encountered in a real life situation.

# Chapter Ten

# An Overview of Managers' Attitudinal Profiles

## 10.1 Introduction

Previous chapters (5 to 9) dealt with managers' attitudes and views on the benefits and problems associated with privatization. For this purpose managers were classified into four groups:

- senior managers in industrial SOEs (ICs),
- middle managers in industrial SOEs,
- senior managers in non-industrial SOEs (NCs), and
- middle managers in non-industrial SOEs.

Data on the responses of the four groups of managers were presented in tables in the earlier chapters. However, there was limited discussion of the differences between the responses of the groups and their interpretation. There could be good reasons for differences in attitudes, preferences and understanding of issues between managers at different levels and managers in industrial and non-industrial SOEs.

One might suspect that senior managers, are more concerned with strategic and legal issues while middle managers are more concerned with labour problems, operational aspects and possible threats of loss of employment. Managers of industrial companies (ICs) might show views on valuation different from those expressed by managers of non-industrial companies (NCs) and may have a different level of concern, for example, because of exposure to international competition for example.

Profiles of the views and attitudes of each group of managers is sketched out first and then differences and similarities between them are discussed. To avoid repetition with earlier chapters no detailed statistical results are presented here, but references to relevant sections and tables are given.

## 10.2 An Overall Attitudinal Profile of Senior Managers in ICs

- **Views on the Public Sector**

  This group of managers feel that SOEs were not very successful in attaining the development and social justice goals they were meant to attain (section 5.3.2). Nevertheless, they still consider the public sector complementing the private sector by investing in areas in which the private sector is not keen to invest. But they assert that it should still seek profits not just "development objectives." They clearly accept that for industrial enterprises, especially where they are subjected to competition, commercial objectives are paramount and must be separated from social and development ones (section 5.3.1, table 5.4). The major problem for the sector as they see it is excessive bureaucracy and slow decision-making. This suggests that they put the blame for the poor performance of SOEs in general and their own organization by implication n factors beyond their control – an understandable human response (section 5.3.6, table 5.9). They reject the allegation of inefficiency in the public sector (section 5.3.5), which shows some inconsistency in views, especially that they admit that commercial success factors are more inherent and evident in the private sector than in the public sector.

- **Acceptability of Privatization**

  All managers in this group indicate that they either agree or strongly agree with privatization (section 5.4.2, table 5.13). They associate it with liberalizing the economy as a whole and getting rid of loss-making companies. But they are not very enthusiastic about selling all companies and they are certainly reluctant to sell their own companies (section 5.4.1, table 5.12). It seems that managers see privatization as inevitable but not necessarily an advantage. Their responses reveal their acceptance of restructuring procedures preceding or accompanying privatization rather than with sale (section 5.4.5 and 5.4.6). It is also evident that they have fears concerning possible problems related to privatization e.g. unemployment effects. They also expressed their concerns about changing company policies (section 5.4.4, table 5.15).

- **Satisfaction with Legal Framework**

  All managers in this group see the many changes introduced by the new law was useful, but insufficient. Actually some of the managers admitted they would prefer returning to the old law managing SOEs. Although the majority of them were aware of the problems related to the old law, most thought that the new law solved those problems only to some extent (section 6.8.7, table 6.2). Many of them found some shortcomings in the new law especially in issues related to labour and BOD rules (section 6.8.6 and 6.8.7). The most important thing added by the new law according to their views was liberalizing SOEs from Government interference and drawing a line between the Government social role and its economic role (section 6.8.3, table 6.3). Surprisingly, most of the senior managers of ICs expect better performance of SOEs as a major outcome of the new law. Some even expected an increase in the number of SOEs. This shows that many of the senior managers of ICs expected continuation of SOEs and revealed some rejection of the inevitable expected decrease in the number of SOEs (section 6.8.5, table 6.5).

- **Perceptions of Problems Impeding Sale of SOEs**

  Senior managers of ICs are most concerned about unavailability of prospective buyers with sufficient financial resources for the units offered for sale. They are also worried about different restructuring procedures, especially possible ways of dealing with past debts and labour problems. They viewed possible labour resistance as a major problem that could hinder implementation. They also felt that precision in valuing SOEs prior to sale is nearly impossible (section 9.12.3, table 9.3). Insufficiency of information about policy and future plans was another problem they mention (section 5.4.7, table 5.18). The problems senior managers raise are in fact serious; they could indeed impede the smooth and easy sale of SOEs. Some of the problems reveal lack of awareness of those managers of possible actions and solutions.

## 10.3 An Overall Attitudinal Profile of Middle Managers in ICs

- **Views on the Public Sector**

Although the majority of middle managers of ICs agreed that the public sector was not successful at all in attaining its objectives (section 5.3.2, table 5.5), they felt that the national role of SOEs is pursuing development goals and investing in areas the private sector could not afford or was not interested in (section 5.3.1, table 5.4). They saw many advantages of SOEs staying in Government hands ranging from the social role of SOEs to the tight control Governments have on SOEs. They even thought that public ownership resulted in higher efficiency but blamed bureaucracy, overstaffing, slow decision making, weak financial resources and political influence on companies for poor performance (section 5.3.3, table 5.6). However, most managers in this category thought that economic success factors were more evident in the private sector and very few of them thought they were evident in both public and private sectors alike (section 5.3.8, table 5.11).

- **Acceptability of Privatization**

Most middle managers in ICs either agree or strongly agree with the privatization policy (section 5.4.2, table 5.13). They saw it as liberalizing measures in the economy and sale of public sector enterprises or assets. Some managers in this group did not welcome privatization (section 5.4.1, table 5.12). Those who objected to privatization drew attention to several drawbacks they considered serious, e.g. unemployment and threats to social justice (section 5.4.4, table 5.15). Around 71% of managers in this group welcomed the sale of their companies as part of the privatization programme (section 5.4.5, table 5.16A). Many of the managers in this group stated that their companies are successful and able to compete *"whether in the private sector or the public sector"*. Some 30% are quite reluctant to accept immediate sale. Their reasons vary from *"have to sell essential products at social prices"* to *"public performance in this particular industry is satisfactory"* to *" our company is a strategic company "* (Table 5.16A, B and C).

- **Satisfaction with Legal Framework**

The majority of IC middle managers raise the question of excessive centralization of decision-making as the major drawback of Law 97/1983 (section 6.8.1). More than one quarter of this group felt that even the new law did not *"solve at all"* the legal problems (section 6.8.2, table 6.2). They generally conceded that the new law had succeeded in *"applying the principle of separating management from ownership"*, *"liberalizing public sector companies"* and *"increasing competition"* (section 6.8.3, table 6.3). But a substantial section of this group of managers felt that there was still a long way to go to say that that legal environment was adequate or sufficiently favourable to efficiency. They indicated that new legal measures were required to smooth out labour problems, to tie the promotion of senior management to performance, to allow the choice of BOD members from inside the company and that problems of past performance e.g. past debts had to be dealt with (section 6.8.7, table 6.7).

- **Perceptions of Problems Impeding Sale of SOEs**

In addition to their reservations on the suitability of the current legal framework for successful privatization and / or restructuring, this group of managers draws attention to a number of serious problems from their points of view. Most crucial among these problems was labour resistance; about one third of ICs middle managers expected resistance to privatization among the employees of SOEs (section 5.4.7, table 5.18). Effective confrontation had to be worked out. They felt that the problem was even more acute because there was a clear problem of overstaffing, hence redundancy is imminent (section 8.9.2, table 8.9). Ways had to be developed to effectively deal with unemployment. Some managers were doubtful about the effectiveness of SFD in handling the problem. Managers of this group also pay a great deal of attention to voluntary retirement and would definitely accept such schemes were they appropriate. Only very few said they would not (section 8.9.8, table 8.15). The majority also said they would buy company shares, if offered at reasonable prices and terms (section 8.9.9, table 8.16). One other problem they drew attention to is the *"low interest of prospective buyers"* if we offer units for sale (section 5.4.7, table 5.18). Such possible obstacles to privatization are due, in their view, to the *"low income of the majority* *of the population*" - an obstacle that needs decades to overcome, or else find buyers from abroad.

## 10.4 An Overall Attitudinal Profile of Senior Managers in NCs

- **Views on the Public Sector**

The majority of senior managers in NCs think that success has been achieved *"to some extent"* by SOEs in meeting the goals. Only one quarter of the group think otherwise, i.e. *"objectives were not attained at all"* (section 5.3.2, table 5.2). To explain the success of the SOEs, senior managers of NCs mention three reasons: *"competition harms consumers while public monopolies don't"*, *"public ownership results in higher efficiency"* and *"public ownership guarantees employment for graduates."* They also explain it by the *"tighter control"* public ownership allows (section 5.3.3, table 5.6). It is rather surprising that 83% of this group disagreed strongly with the views expressed above that SOEs are inefficient. Sometimes SOEs are inefficient, they concede, but this is not inherent in public ownership (section 5.3.5, table 5.8). Rather it is due to Government interference, low managerial skills or slow decision making (section 5.3.6, table 5.9). Perhaps some inconsistency in views emerged when they were asked whether success factors are more evident in the private or the public sector. The majority said *"in the private sector"* (section 5.3.8, table 5.11).

- **Acceptability of Privatization**

The majority of senior managers of NCs agree or strongly agree with the continuation of privatization attaining *"a more liberalized economy,"* to *"increase public enterprise efficiency"* to *"increase private ownership of productive assets"* and to *" redirect investment"* (section 5.4.2 and 5.4.1). So, they expect continuation of public enterprise in some sectors at least. This group, like other groups, consider *"unemployment effects"* the most important disadvantage of privatization (section 5.4.4, table 5.15). It is interesting to note that 40% of this group of managers do not welcome that their companies are given priority in the privatization programme. It seems that they are still a little skeptical about future events. So they accept privatization, but would like it to be implemented elsewhere at first. They justify their views by stating that their companies are already successful as they are, so *"why change?"* (section 5.4.5, table 5.16A, B and C).

The responses of senior managers of NCs showed that agreement with privatization was widespread among them; many of them believing that it was panacea for the ailing Egyptian economy. Yet, they did not welcome its application to their companies. This raises doubts about their whole hearted acceptance of privatization. They accept it in principle but are apprehensive about its implications for themselves and their companies. This means that they are likely to see problems in implementation than to venture solutions.

- **Satisfaction with Legal Framework**

Less than half the managers in this group felt the new law had helped solve the chronic problems in the legal environment of SOEs. Only 12% felt that problems had not been solved at all (section 6.8.2, table 6.2). Two major improvements were introduced by the new law, according to the managers. These are: a) separating ownership from management, a long awaited demand. b) liberalizing SOEs from excessive Government interference. One other important improvement was basing promotion of managers on performance (section 6.8.3). The major problem left unsolved by the new law was *"blurred responsibility between holding and affiliated companies"*. To improve the legal environment this group of managers recommend revising worker participation in BOD's and empowering management to deal more freely with problems related to workers (section 6.8.6, table 6.6).

- **Perceptions of Problems Impeding Smooth Privatization**

Past debts were top of the list when senior managers of NCs were asked about the possible problems impeding privatization. They felt the Government should deal with this problem through capital increases, grace periods, rescheduling or capitalizing debts as a part of restructuring (section 7.8.4, table 7.9).

Senior managers of NCs agreed with those of ICs that *"unavailability of interested prospective buyers"* and *"low income of the majority of the population"* were among the most important problems that might hinder privatization. Valuation of units offered for sale could also cause serious problems. They recommended valuation to be carried out by independent parties indicating that market value should be the main base of valuation (section 9.12.1, table 9.1). Unavailability of sufficient information related to the new changes and possible labour resistance were also given considerable weight by the managers (section 5.4.7, table 5.18). One notes that the problems they raise are quite similar to the problems raised by senior managers of ICs.

## 10.5 An Overall Attitudinal Profile of Middle Managers in NCs

- **Views on the Public Sector**

Around 70% of middle managers of NCs hold the views that SOEs have succeeded in carrying out their social role either to a large or to some extent (section 5.3.2, table 5.5). They also think that *"public ownership results in higher efficiency"* and assert that *"competition harms the consumers while public monopolies don't"* (section 5.3.3, table 5.6). The only two major disadvantages of the public sector in their views are: bureaucracy and overstaffing, and those could be rationalized (section 5.3.4, table 5.7). More than 85% of managers in this group disagreed with the inefficiency allegation of the public sector (section 5.3.5, table 5.8). Why are SOEs performing below expectations? They say it is mainly political interference, shortage of finance and ineffective training programmes resulting in managerial skills (section 5.3.6, table 5.9). However, they admit that *"absence of private owners' control and concern"* is in many cases the main reason for low performance of SOEs and that *"marketing"*, the most important success factor in business, according to them, is more evident in the private sector than in the public sector (section 5.3.7, table 5.10).

- **Acceptability of Privatization**

When asked whether they agreed with the privatization policy, nearly all middle managers of NCs said they did (section 5.4.2, table 5.13). This might be a little inconsistent with their views on the public sector presented above. Why privatize? They indicate several possible advantages: increasing efficiency, more liberalization of the economy, increasing competition, widening the ownership base and earning revenue through sales of SOEs (section 5.4.3, table 5.14). But they warn against the drawbacks of privatization. Among these they mention unemployment, threats to justice and threatening development plans (section 5 4 4, table 5.15). In fact, 40% of managers in this group would prefer that their companies not to be included in early privatization projects (section 5.4.5, table 5.16A), but they welcome restructuring. The most frequent reason mentioned for preferring the delay of implementation is *"privatization must be postponed until labour and liquidity conditions are adjusted"* (table 5.16 A and B). It is worth mentioning here that the majority of managers think that security is the most important advantage of working in SOEs (section 8.9.7, table 8.14).

- **Satisfaction with Legal Framework**

Government interference is the main problem of the legal environment in the opinion of this group of managers. This is of course compatible with limited decision making at company level. The new Law 203/1991 has made marked progress on this. Empowering managers to work with *"the private sector mentality"* and paving the way for the use of scientific management approaches" are two major advantages of the new law. Abolishing some bureaucratic procedures and separating management from ownership are two more advantages (section 6.8.3, table 6.3). Managers in this group expect better performance of SOEs under the new law and 15% of managers expected an increase in the number of SOEs (section 6.8.5, table 6.5).

It is only fair to say that the legal framework in Egypt is not sufficiently adequate. Managers' expectation of the increase of SOEs is a little unrealistic. The GOEs has for some time stopped any more investment in the public sector and creation of new SOEs is not expected.

- **Perceptions of Problems Impeding Sale of SOEs**

NC middle managers give the problem *"low income of the majority of the population"* and possible *"unavailability of purchasing power"* the greatest importance among factors that might hinder privatization. *"Labour resistance"* is another major problem they indicate (section 5.4.7, table 5.18). Also a majority of managers identify overstaffing as a major problem, despite the fact that 30% of them think that there is no overstaffing (section 8.9.2, table 8.9). Managers in this group seemed to accept most of the proposed compensation schemes proposed by the Government but many of them stated their preference for retraining and staying in their own companies as compared to starting their own business (section 8.9.10, table 8.17). Nearly a quarter of managers in this group had never heard of SFD and do not recognize its role in curbing unemployment (section 8.9.12, table 8.20). This reflects a problem in communication. Managers of SOEs, especially those which are the first to be privatized, should not only be aware of SFD's role, but should also be able to communicate it to their subordinates and employees.

## 10.6 An Overall Analysis and Comparison of Managers' Views

- **Managers' Views about the Public Sector**

Managers' responses have shown how they perceive the different objectives of SOE and how they think that most of them were not attained at all. Their responses show that middle managers give more importance to social objectives especially in NCs. Yet senior managers' responses show that they accept that the SOEs' main objectives have changed from their previous social goals to more economic ones (section 5.3.1, table 5.4). One possible explanation for this is that middle managers are more aware of the social problems to be faced by the unemployed while senior managers are more concerned with big structural issues whether at the company level or at the economic level.

Although the majority of managers in all categories admit that SOEs have either not achieved objectives or achieved them to a small extent (section 5.3.2, table 5.5), they refuse to admit inherent inefficiencies in the public sector (especially the middle managers in NCs) (section 5.3.5, table 5.8). Many of the senior managers in ICs and NCs identified *"competition harms consumers while public monopolies don't"* as the most important advantage of SOEs staying in Government hands (section 5.3.3, table 5.6). Their responses show that many of them still do not welcome equality of treatment between public and private sector companies and find this equality biased to the private sector and sometimes even against SOEs' interests (section 7.8.3, table 7.8). This reflects their fear of SOEs' loss of the many advantages they used to enjoy for many years e.g. Government subsidies and lenient credit. This issue has been repeatedly raised in Egypt. Public sector managers have been for long enjoying preferential treatment, whicnt, which the want to lo:

Reasons for low performance of SOEs varied from one category to the other (section 5.3.6, table 5.9). While senior managers in ICs and NCs gave the highest weight to political influence on companies, the middle managers thought *"slow decision making"* was the problem. This is understandable since senior managers are more exposed to the political influence while middle managers experience slow decision making possibly because of bureaucratic relationships between SOEs and the Government. Surprisingly, many of them admitted that *"low management skills"* was also a factor causing low performance which implies admission that their own performance could be better. However, they explained it by *"inefficient training programmes"*.

*"Weak financial resources"* was ranked high by managers especially middle managers in ICs. This is rather odd since for many years, all SOEs have been enjoying many financial advantages, which the private sector has no access to (e.g. direct and indirect subsidies and low interest loan). The managers also acknowledged *"bureaucracy"* *"overstaffing"* and *"difficulty of control in the public sector"* as factors causing low performance. All these responses show that they see many disadvantages in public ownership. Most importantly, many of them - especially middle managers - mentioned *"absence of private owners' control and concern"* as an important factor contributing to poor performance. The majority of managers in the four categories stated that efficient marketing is the key of successful economic performance and admitted it was more evident in the private sector (section 5.3.7, table 5.10).

- **Acceptability of Privatization**

The majority of managers in all types of companies show a high level of understanding of the concept of privatization. On the whole, they do associate it with liberalizing the economy. Sale of public sector enterprises and assets seemed to be more expected by middle managers, especially those of ICs, than senior managers. Senior managers of ICs were the least to accept selling of assets (section 5.4.1, table 5.12). When asked directly about the extent of their agreement with privatization, the majority of managers in all categories either agreed or strongly agreed with the privatization policy (section 5.4.2, table 5.13) and stated that their company should have priority in the privatization. Nevertheless, when they were asked when they thought the transfer to the private sector should take place, most of them (especially senior managers) stated it should either be after five years or later and many of them acknowledged they wished their companies would never be privatized (section 5.4.6, table 5.17). This shows that although they agree in principle with privatization they do not want their own companies to be privatized in the near future. On the other hand senior and middle managers of NCs seemed to be more consistent in their responses. More of them admitted they don't think their company should have a priority in the programme and when asked about the time the transfer should take place, most of them chose five years or later. This means that they are not highly enthusiastic about privatization.

Most managers who wanted their companies to have priority in the programme stated that the accompanying restructuring procedures would benefit the company and that they were confident their company would succeed whether it was public or private. Many senior managers in ICs however stated "*there is no other alternative*" which showed that they thought of privatization as an inevitable change that had to happen, whether they agreed or not. On the other hand, reasons managers mentioned for their company not being a priority in the programme showed that many of them are still persuaded by the advantages of SOEs staying in Government hands e.g. *"public performance in this industry is satisfactory"*, *"the company offers essential products for low fixed prices"* and *"our company is a strategic company"* (section 5.4.5, table 5.16A, B and C).

Most of the managers' responses in ICs and NCs show that although they expect *"heading towards a more liberalized economy"*, *"increased competition"* and *"redirecting national investment"* to be aspects of Government policy, the majority of them expect SOEs' to continue in the public sector with increased efficiency. *"Reducing the size of public sector"* and *"earning Government revenue through SOEs' sales"* were given the least weights by managers in all categories (section 5.4.3, table 5.14). This shows that most managers are not swayed by the macroeconomic advantages of privatization.

All managers in ICs and NCs warned about possible *"unemployment effects"* which according to many of them was also the greatest problem hindering privatization. Most of them showed their concern about *"changing company policies"*, *"the possibility of changing managers"* and *"adding new authority of owners to Government authority"* (section 5.4.4, table 5.15). In general, managers' responses reveal their feelings of insecurity. They are worried about the unemployment problem and the possible threat to social justice and development plans, but they are also concerned about the changes that might affect them directly.

- **Perceptions of Problems Impeding Sale of SOEs**

The majority of managers gave the problem "*low interest of prospective buyers*" the greatest importance among factors that might hinder privatization. Those who did not, chose "*low income of the majority of the population*", which is also a related problem leading to low purchasing power. This problem also seems to be one of the major concerns of decision-makers, whether Government policy makers or implementers of privatization. "*Unavailability of information*" was given considerable weight by most of them. Managers also stressed the importance of "*labour resistance*" as a hindering factor. IC and NC senior managers especially mentioned problems of past debts as a hindering factor and suggested some possible solutions. They stressed that there should be a plan at the macro level to solve this problem. Political resistance was given more importance by managers of NCs then by those of ICs (section 5.4.7, table 5.18). This result is to some extent different from what one would have expected. Industrial companies usually have more concerns about political resistance because of the large number of workers they employ and the potential for more national and international competition.

Most senior managers (more than 90%) of ICs and NCs did not expect 100% accuracy in valuation of SOEs. Most of them expected an 80% degree of accuracy. A few of both categories claimed it was impossible to be accurate (section 9.12.3, table 9.3). These responses reveal the difficulty of the valuation process. They also explain why implementers of privatization and managers do not try to simplify the long and time-consuming procedures of valuing SOEs.

- **Satisfaction with Legal Framework**

Managers mentioned several problems that were related to the old law. However, most of them did not feel that these problems were solved to a large extent by the new law. Senior managers of ICs seemed to think these problems were solved to a larger extent than the other categories of managers (section 6.8.2, table 6.2).

Senior managers of ICs and those of NCs agreed that "*liberalizing public sector companies from the interference of the Government*" and "*applying the* *principle of separating management from ownership"* were the two most important changes introduced by the new law. In general senior managers in ICs seemed to be more aware of the new changes. Many respondents in the other categories either chose not to answer or mentioned there was no change (section 6.8.3, table 6.3).

When questioned about the degree of importance of some of the changes introduced by Law 203/1991 senior managers' stated that liberalizing SOEs and giving them more autonomy are the most important changes they expected. In both ICs and NCs they *"ranked permission to sell SOEs'"* as sixth, which shows their expectation of their continuity in the public sector. Middle managers in both types of companies seemed to be more aware or expectant of the inevitable change of hands (from public to private ownership). They ranked this change as third. Middle managers of ICs gave it the highest ranking as compared to the other manager categories (section 6.8.4, table 6.4).

Responses of the senior managers of ICs show that many of them expect continuity of SOEs in the public sector. Some of them even expect creation of more SOEs, while only a minority expect them to decrease. Although most NC senior managers agreed with those of ICs in their expectation of better performance of SOEs, more of them expected that SOEs would decrease in number. The highest expectancy rate of the inevitable decrease in SOE numbers was among the middle managers of ICs. They were followed by the middle managers in NCs (section 6.8.5, table 6.5).

Most of the managers in all categories agreed that *"problems of past performance e.g. past debts"* were the most urgent and that they were left unsolved by the new law. This highlighted one of the most important problems that faces privatization. It is important that these problems be addressed promptly especially since many SOEs face them (section 6.8.6, table 6.6).

The most important change that could be added to the new law according to both IC and NC senior managers was *"adjusting the rules that govern the creation of the Board of Directors"* and *"changing the attitude towards SOE capital as money without an owner and no accountability"*. They made several other suggestions. Although some of the middle managers also mentioned some propositions, many of the IC and NC middle managers were satisfied by the law as it is (section 6.8.7, table 6.7).

- **Managers' Views about Labour Issues**

Possible labour resistance was mentioned by most of the managers in all categories as a major obstacle to privatization (section 8.9.1). Most middle managers think their companies have too many employees. Although some of the managers refuse to admit the problem, there is an overstaffing problem in many of the NCs and ICs (Handousa, 1991). Many of the managers in both types of companies stated that the problem exists in all departments and is especially evident in administrative departments (section 8.9.2 and 8.9.3).

The majority of managers thought that security of employment was the most important advantage of working in SOEs. Next, but far behind in importance was insurance and pensions (section 8.9.7, table 8.14). Early retirement schemes seemed more widely accepted by managers in ICs than by managers in NCs. Possibility of purchase of shares seemed more widely accepted by managers in ICs than by managers in NCs. Yet, in both cases a large number of managers stated they would not buy shares. This makes the success of a compensation scheme built on share distribution more difficult. Retraining on new systems was more frequently chosen by middle managers of ICs and NCs. The most frequent reason they chose this was to increase their efficiency to continue working in their company. This reflects an understandable fear of the risks facing a privatized company. A high percentage in both ICs and NCs stated they would not accept transfer to other companies. However, it seemed more acceptable in ICs than in NCs. These responses should be considered in designing compensation schemes (section 8.9.8 to 8.9.11).

Most managers in ICs and in NCs were aware of the role of the SFD in curbing unemployment effects and thought it was useful. However there was a considerable number in both categories who have not heard of it. Some managers had heard about it but thought it was not useful for them (section 8.9.12, table 8.20).

## 10.7 Conclusion

This chapter sought to draw an overall picture of attitudinal profiles of different groups of managers:

- senior managers in ICs,
- middle managers in ICs,
- senior managers in NCs and
- middle managers in NCs.

Some differences in emphasis were identified and have been discussed above but in general the responses of the four groups represent similar attitudes. They all have their doubts about SOEs and a majority of senior managers admits their failure in achieving their development objectives. Nevertheless the majority of all groups do not accept that the public sector is inherently inefficient. Non-acceptance of inherent inefficiency was the strongest among middle managers especially in NCs.

Most managers in all groups accept privatization as a policy. However, their commitment to immediate plans of privatization varied between groups. In general, there is a preference though is a preference for postponing implementation in their own companies. It seems that managers of all groups judge that privatization is inevitable. So, they accept it, but would prefer to delay implementation in their own companies. They think that the public sector still has a major role to play, at least in the immediate future.

All managers consider the introduction of Law 203/1991 a major step improving the legal environment. However, many of them feel that there are still some issues that need to be addressed. Actually, senior managers in ICs and NCs had many suggestions about changing the law. Middle managers of NCs were the only group that did not make any suggestions and seemed to be satisfied with the new law.

Restructuring efforts seemed highly accepted by managers in the two types of companies and they were very optimistic about the results. Early retirement schemes seemed more accepted by managers in ICs than by those in NCs. Retraining was preferred by managers of both types of companies to starting their own businesses or transferring to other companies. Accuracy of valuation seemed to be an area of concern to senior managers in both industrial and non-industrial companies.

Managers in all categories (with some differences) accept that some changes in SOEs and their environment are inevitable and indeed some of the changes have already happened (e.g. changes in the legal framework and privatization of some SOEs). The managers also appear to have some resistance to privatization (see Zaltman and Duncan, 1977). A number of reasons for this resistance can be identified. One set of reasons can be related to an understandable conservatism on the part of the managers who identify strongly with SOEs and are threatened by the possible implications of privatization for them. Therefore the resistance is likely to be partly based on idealism about the principles and objectives underlying the role of the public sector in a developing economy, partly on suspicion of the private sector and partly on concerns about their own abilities to survive in the private sector and possible threat of redundancy.

Resistance may also be based to some extent on their own knowledge of the public sector, weaknesses of their own SOEs and therefore doubts about their ability to survive as privatized enterprises, possibly facing competition. There may also be concerns about the broader factors such as possible Government interference after privatization, whether the Government would reduce the debt burden of the SOEs before privatization, whether the conditions in the Egyptian economy would be favourable and whether labour tensions would make management difficult.

On the whole, one could conclude that whether applied in industrial or non-industrial companies, privatization is not truly accepted by many senior or middle managers. Senior managers have their concerns about possible adverse results and changes in company policies while middle managers fear the unemployment effects and expect a lot of resistance. Senior managers also have concerns about the inadequacy of the accompanying legal framework and accuracy of valuation, which should also be taken into consideration by policy makers. Since managers are the key implementers of privatization and their acceptance is a key to successful implementation of privatization as mentioned earlier in the literature review and in the theoretical model, it is essential to work on gaining their acceptance in both industrial and non-industrial companies with a special focus on senior managers.

# Chapter Eleven
# Summary and Conclusions

## 11.1 Objectives of the Research

This study aimed to identify and analyze some of the major problems encountered in the implementation of the Egyptian privatization programme and in particular to appraise the views of public sector top and middle-level managers regarding the main issues of privatization and the implications of these views for effective implementation. An original contribution of the research is the detailed examination of the views and attitudes to privatization of senior managers of SOEs in a developing economy context.

## 11.2 The Methodology Employed in the Study

The researcher has used three different methods of investigation, each suited to the type of information and analysis required. For the examination of privatization at the policy making level, the main sources were interviews with representatives of Government, official documents and published official reports and academic papers. Questionnaire surveys were used to assess the views and understanding of privatization by managers of SOEs. Detailed case studies were used to provide a more in-depth account of some of the important issues related to privatization, e.g. restructuring, labour issues and valuation of SOEs. Interviews were carried out where appropriate with relevant sources (including senior Government representatives to support the case studies.

A good-practice privatization model based on the literature survey was set out. The study then described and analyzed the actual practice of privatization in Egypt in comparison with the model identifying problems at the national policy level, at the industry level and at the company level.

Surveys of managers were a major part of the research. Their results were used to describe and study the opinions and attitudes of middle and higher level managers in industrial and non-industrial public enterprises regarding the different issues of privatization in Egypt. Attitudes were analyzed to reveal how far middle and top managers are committed to privatization. The surveys also helped to solicit their views about different problems and issues of privatization. Problems of implementation were then analyzed in an effort to develop confrontation strategies.

The basic methods of research employed in the study and a summary of their results are summarized below:

## 11.2.1 Literature Survey

The literature review indicated that privatization has the potential as a policy to solve many problems of PEs. Although there are some difficulties and problems associated with the implementation process, many analysts have agreed that they could be overcome. The literature review also revealed how managers affect and are affected by institutional changes, especially by a drastic change such as privatization. It highlighted the role of managers in the transformation process and the importance of their acceptance of the new policy for smooth implementation of privatization. There appears to be very little previous empirical evidence on the views and attitudes of managers of SOEs and to what extent they accept and desire privatization. This area needs exploration to assert whether managers' attitudes affect the implementation process. These findings influenced the researcher in designing the research questions and in formulating the hypotheses.

## 11.2.2 Field Work

The field work in this study consisted of three major components described below.

### 11.2.2.1 Interviews for Examination of Policies at the Macro Level

A number of interviews were held with relevant parties to clarify the Government privatization policy and its latest developments, its relationship with the stock market and the role of the Social Fund for Development (SFD) in the privatization process. The interviewees were:

-The Public Enterprise Deputy Minister and his senior staff;

-The Public Enterprise Office Chairman and his staff;

-Managers at the Social Fund for Development in charge of absorbing unemployment caused by the privatization programme;

-Capital Market Authority officials;

-Brokers in the Stock Market; and

-Businessmen[1]

Interviews were used in this study where it was felt more elaborations and clarifications were necessary. Although interviews in some cases allow for subjectivity, face to face contact has the advantage of allowing the interviewees to communicate their views more effectively than through a written questionnaire. This part of the study was most beneficial in securing a clear understanding of privatization issues at the macro, policy-making level.

#### 11.2.2.2 Attitude Survey

To identify the attitudes of Public Enterprise executives regarding *privatization two questionnaires* were administered to solicit information and measure attitudes from the following groups:

- A sample of top management executives in holding and affiliated public enterprises (Questionnaire A).
- A sample of middle level managers in affiliated public enterprises (Questionnaire B)

The responses were then summarized, tabulated and embodied in the relevant chapters. Chi-square tests were applied to test the statistical significance of the results. A separate profile for each group of respondents was created to examine the degree of similarity and differences among the different groups of managers and whether they were from industrial or non-industrial enterprises. A summary of the results is included in section 11.3.4.

[1]Several businessmen were interviewed to find out what their views were concerning privatization, methods of sale of PE's and their readiness to invest in such purchases.

#### 11.2.2.3 Case Studies

Questionnaires and interviews solicit the main data to test the hypotheses of the study. Nevertheless, the researcher felt the need for a more in-depth investigation of some issues through three case studies.

The Egyptian Company for Refractories Case → Enterprise Restructuring problems
Alexandria Ship Yard Co. Case → Labour issues
The Sheraton Sale Case → Valuation problems

### 11.2.3 Was the Chosen Research Methodology Appropriate?

The researcher has adopted a triangulation strategy with three main sources of information (interviews, surveys and case studies) at three different levels of implementation (policy, industry and enterprise). The preliminary literature review set the context of the research and provided the basis for formulating the research problem and hypotheses more precisely and for designing the surveys. Relevant documents[2] and published reports were examined where appropriate. Interviews at the national level allowed the researcher to gain a broad view of the progress of privatization in Egypt. The surveys at the industry level enabled the researcher to identify and assess the major problems of implementation at the industry level and how the attitudes of managers influence the process. Finally, case studies enabled the researcher to examine in depth some of the major problems of implementation. The research methods were complementary. The sample survey provided a summary of PE managers of views and attitudes on a wide range of privatization related aspects while the interviews with policy makers and company case studies provided more detailed insights into selected aspects which could not have been obtained from the survey alone. Because of the nature of the study, there are subjective elements in all the three methods. However, overall the three approaches to data collection taken provide a rounded view of the privatization process in Egypt and its problems.

[2]This includes official GOE documents e.g. laws, documents about SOEs and privatized companies in the PEO and the Public Enterprise Information Centre. Also company internal documents for the case study companies were examined.

## 11.3 Major Findings and Recommendations

The findings and recommendations of the study can be summarized as follows:

### 11.3.1 Development of a Proposed Model for Privatization

Based on relevant literature a 'good practice' model for the smooth and effective design and implementation of a privatization programme was set out (Chapter Two). The researcher relied on this model to assess actual privatization practice in Egypt. The model summary is reproduced in Figure 11.1.

**Figure 11.1: Privatization Steps: A "Good Practice" Model**

**Policy-making Level**
**(Largely a question of political commitment and effective implementation at the policy making level )**

-Check whether privatization is actually desirable
-Develop a plan dealing with the different stakeholders and resistance groups
-Develop and implement a comprehensive programme of macro-reform
-Change laws and companies' systems to make them more suitable for privatization
-Develop a comprehensive plan of privatization
-Develop adequate and strict programmes of privatization
-Create a structure responsible for implementing the programme in which responsibility levels of implementation are clearly defined allowing for adequate accountability
-Develop a clear monitoring system with required accountability procedures
-Determine different methods of dealing with the management and work force
-Develop a comprehensive marketing plan for the privatization policy and programmes
-Develop a promotion plan using different media

↓

**Implementation Level**
**(Mainly a question of effective communication and efficient implementation)**
**A. Industry Level**

-Clarify the programme to all those involved
-Establish a communication network to discover and overcome any problem
-Develop a restructuring programme for low performing units
-Choose privatization candidates
-Choose appropriate privatization method for each candidate
-Choose the most approprite valuation methods to reach the most adequate price for SOEs offered for sale
-Apply the most appropriate pricing mechanism in case of public offerings
-Prepare feedback for the monitoring system

↓

**B. Enterprise Level**

Prepare privatization candidates by:
-Making sure managers at the different management levels fully understand and have a positive attitude towards privatization
-Clarifying the situation for the work force and specifying their alternatives making sure they accept the new policy
-Restructuring the unit if needed
-Clearing the entangled situations related to previous privileges, contracts or obligations
-Apply the most appropriate privatization technique for the company
-Prepare feedback for the monitoring system

### 11.3.2 Assessment of Current Privatization Practice in Egypt

As indicated earlier, findings and conclusions have been set out using the Model steps for implementation of privatization as a checklist to which actual practice is being compared. The main aim of this framework is to systematically identify and assess problem areas. The following account shows the outcome of the assessment.

#### 11.3.2.1 Implementation of Privatization at the Policy-level

Official announcements of the GOE indicate that privatization of many industrial and commercial enterprises could be of benefit. Yet, the rate of implementation casts doubt on GOE's acceptance, desirability and commitment. Moreover, even if all the announced programmes were actually implemented, the total assets privatized would represent only 15% of the total value of Government assets. In 1997 some discussion started on the other "strategic" 85%, but nothing tangible has been done. The GOE has to make sure that privatization is desirable at all planning and implementation levels.

The only evident plan for absorbing resistance of different groups is slowing down privatization implementation and reassurance of the GOE that workers will not be adversly affected by the privatization policy. Yet, survey results showed that 20.1% of the managers wished privatization would NEVER take place. A more sophisticated plan to deal with stakeholders' resistance should be developed, not only at the workers or managers level, but also at the policy making level.

The Egyptian Economic Reform programme has been designed and implemented with quite successful results (Chapter Three). New laws were issued to govern the Stock Market and SOEs. Other laws concerning labour and financial markets are still being developed. Although Law 203/1991 has successfully tackled some of the weaknesses in Law 97/1983, it still has some major drawbacks. Examples of some of the issues that still need to be addressed are lack of ways to deal with past debts, blurred responsibilities, continuity of Government interference, labour resposibilities and labour laws and BOD formation regulations. Responses of the managers of the SOEs show that some of these drawback have been adequately addressed, while others need further effort in order to make the new framework more complete (adequacy of the present legal system was discussed in Chapter Six).

Completing the development of the adequate legal framework of privatization is recommended.

As evident in Chapter Four, actual implementation has shown that the announced programme is not adhered to strictly. This could be attributed to inadequacy of the programme or to the surrounding circumstances creating obstacles to full implementation. The GOE should make sure that the privatization programme is adequate for the circumstances and then implement the announced programme in a stricter manner.

A clear structure was established to run the implementation of privatization. Responsibilities of the different implementing groups are clearly defined. Yet accountability for delay in implementation and who should be held responsible is rather vague (Chapter Four). An adequate accountability system should be developed in which whoever is in charge is held responsible for results.

Although there is a ministerial committee in charge of monitoring the implementation of privatization, its effectiveness needs enhancement (section 4.3.3). Comparing actual implementation with initial objectives and plans shows slow implementation. Yet, no one seems to have actually been blamed or held accountable, for the delay of implementation. There should be a clear monitoring system that checks implementation as compared to plans at the policy level, industry level and enterprise level.

Several schemes have been developed and a new law is being studied to create the right environment and the appropriate mechanisms for successful privatization. However, labour issues seem to be causing slowness of implementation (for more details see Chapter Eight). The GOE has to ensure that redundant labour schemes are sufficiently attractive for SOE employees including managers. The role of the Social Fund for Development in absorbing redundant labour should also be re-checked and reinforced.

Doubts about desirability and adequacy of private purchasing power were identified by managers as important obstacles slowing down implementation of privatization. This shows the need for a comprehensive marketing plan that takes account of potential purchasers of SOE and their ability to pay in determining the types of purchasers to pursue and the balance of ownership between them (e.g. local and interntional), pricing (e.g. pricing according to valuation, lower prices as an incentive or to overcome resistance by shareholders), how the promotion plan could help open new markets and which SOEs to start with. Marketing efforts were found to be carried out separately at different levels without a comprehensive approach. Most promotion efforts were limited to advertisements announcing "Units for Sale". Pricing is based on a case by case strategy. Local markets are reached efficiently, but a great deal remains to be done to reach international markets. Marketing efforts should be equally directed at promoting the idea of privatization in general and to market certain units in particular.

#### 11.3.2.2 Implementation of Privatization at Industry Level

Each of the "good practice" model steps is mentioned below together with what was found in actual practice:

- **Clarify the Programme to all Involved**

  Many issues concerning privatization need to be clarified, especially to the managers implementing the process. Among these issues are the legal framework of privatization and the different schemes proposed to solve the worker redundancy problem. The Public Enterprise Office has organized several conferences and seminars to clarify the GOE programmes, but they were mostly directed at higher level managers. Most of the managers responding to the questionnaires indicated that unavailability of sufficient information was one of the major obstacles hindering privatization.

- **Establish a Communication Network to Communicate the Changes, Discover and Overcome any Problems**

  The current practice depends mainly on informal communications especially at lower levels of the organization. Lack of communication was identified as a major problem in many cases in the attitude survey. Many issues related to privatization, e.g. labour issues and the legal framework, need to be communicated more effectively. Development of a more efficient formal communication system is needed to clarify the privatization programme, its consequences for the different enterprises and what the new role of the existing work force will be and how they are going to be dealt with especially in lower levels of the organization system.

- **Develop a Restructuring Programme for Low Performing Units**

  A government programme has been initiated to restructure public enterprises that are to stay in government hands. The responsibility of restructuring enterprises intended for sale is left to the purchaser. Although the Egyptian restructuring programme deals with many aspects of restructuring, it falls short of a comprehensive approach or an integrated plan. A more comprehensive approach should be adopted towards restructuring issues.

- **Choice of Privatization Candidates**

  The GOE has established several criteria for choosing privatization candidates. The most important criteria are profitability, medium-sized enterprises or business units operating in competitive business sectors, which do not need financial restructuring, additional investment, operational reorganization, legal restructuring or significant corrective environmental measures.

- **Choice of Appropriate Privatization Technique for each Candidate**

  The four main methods of privatization are liquidation, public share offering, share offerings through the Employee Shareholder's Association and sale to anchor investors. The most commonly used method in Egypt was public offerings. Adequacy of this method for future offerings has become questionable. Other methods should be studied in the light of the circumstances in each case. Selling to anchor investors seems to be an attractive alternative, but procedures of the sale should be simplified. Also conditions of the sale should be clear and agreed upon before starting the sale process.

- **Choose the most appropriate valuation method to reach the most adequate price of SOEs offered for sale**

  The most common valuation method used for pricing public enterprise shares is the Price/Earning Ratio method. In public enterprises sold as going concerns several methods of valuation are applied. The most common ways are the Discounted Cash Flow method and the Replacement Value method. The valuation is usually done by specialized consultants and then reviewed, adjusted and approved by official selling and privatization committees. In liquidated companies and assets prices equivalent to market value are sought. Anchor sales take a long time to materialize mainly because of the long procedures of valuation and fear of under-valuing a public enterprise.

Most managers agreed that valuation of SOEs according to market value and after taking into consideration goodwill is in most cases the most appropriate method of valuation. However, use of several valuation methods to reach an acceptable price is recommended. Although Price/Earning ratio is a good method for pricing public shares, the use of other methods as reference prices could be beneficial.

In valuation of anchor sales, it is important to use several valuation methods. Neither the replacement method nor the discounted cash flow method is appropriate for valuation of anchor sale candidates. Both methods are rather subjective and should be used only as indicators to help reach the most appropriate price. More focus should be directed at income-based methods that take into consideration that the company will continue operation for a long period of time (different methods are described in Chapter Nine). Market value of tangible and intangible assets, e.g. goodwill, should also be taken into consideration.

- **Apply the Most Appropriate Pricing Mechanism in the case of public offerings**

The main pricing mechanism used in share offerings is a predetermined flexible share price that is allowed to fluctuate up to a limit of (plus or minus 5%) according to market forces. The implementation price is the price where supply and demand meet with only those with bids above the market dealing being successful in purchasing shares. The system also allows the GOE to apply discounts in pricing shares when appropriate.

The pricing mechanism used in selling going concerns is usually competitive bids. In liquidated companies or assets, auctions are usually used. This mechanism is appropriate, but more effort should be exerted to attract bidders from international markets. Procedures for anchor sales should also be simplified and shortened to encourage such sales since they have several long-term advantages. Procedures and conditions of the sale should be made clear to all before the selling procedures start.

Fear of under-pricing or being accused of doing so should be faced by more transparency and publicity of the intended sale and of the actual procedures and steps that take place. A method that could also be successfully applied is receiving bids for one week after final price is announced. If serious bids that offer better conditions are received, an open auction could be held within two weeks of the final price being announced. Serious bidders would have to place large insurance amounts to enter the auction and the bids offering the best conditions should succeed.

- **Feedback for the Monitoring System**

Unofficial monitoring of actual implementation of privatization at the industry level might be taking place at high authority levels, but there is no clear formally set out system for doing so. Actual implementation has usually been behind plans and responsibility for delays is not attained or acknowledged.

### 11.3.2.3 Implementation of Privatization at the Enterprise Level

The implementation at the enterprise level is mainly focused on preparing candidates for actual privatization and then applying techniques most appropriate for the company circumstances. Feedback for the monitoring system also has to be made at this level.

- **Preparation of Candidates for Privatization**

The preparation of privatization candidates should take place by:

-Restructuring the unit if needed

-Clarifying the situation for the work force

-Specifying the alternatives for the work force

In actual practice restructuring of candidates takes place according to certain criteria mentioned in the research. However, clarifying the situation for the work force and specifying the different options need more efforts.

- **Applying the Most Appropriate Privatization Technique for the Company**

Choice of the most appropriate technique takes place at the industry level. In this step mere execution takes place and is, as a rule, according to plan.

- **Feedback for the Monitoring System**

  Monitoring efforts should check whether the implementation process has gone smoothly at the enterprise level. It should also check whether the privatization method used was the most appropriate.

### 11.3.3 Major Problems Encountered in the Implementation of the Egyptian Privatization Programme

The major problems encountered in implementing privatization in Egypt were identified as follows:

- Strict and firm implementation of the announced privatization programme is lacking. This could be due to inadequacy of the programme or due to the different obstacles hindering implementation.
- Desirability of privatization at all policy and implementation levels seems to be doubtful.
- Different stakeholders and resistance groups are not adequately confronted.
- The legal framework accompanying privatization is still incomplete and, in many areas, needs development.
- Redundant labour in SOEs is a major problem facing implementation of privatization.
- There is no clear, effective accountability system where those responsible for delay of the programme are held responsible.
- The existing privatization programme monitoring system seems to be ineffective.
- There is no comprehensive approach or plan to market the different privatization concepts in general and the privatization candidates in particular.
- There is no effective communication system that communicates and clarifies the privatization programme to all concerned.
- Many of the SOEs to be privatized in the future need considerable restructuring prior to sale.
- Public offering, which was an effective selling method for many of the previously privatized companies, is becoming increasingly inadequate for

future sales. At the same time the many problems encountering anchor sales have to be solved before it could be relied on as a major selling method.

- Selling procedures and necessary approvals consume a long time, especially in anchor sales.
- In valuation of SOEs there is always fear of underestimating a public enterprise or at least being accused of doing so. This induces government representatives to overvalue companies, which usually causes a problem in finding an adequate buyer.

### 11.3.4 Managers' Attitudes to Privatization and Privatization Issues

As Thorne (1991) states managers should be the *"masters of change"*. The importance of their role in implementing change especially one as radical as privatization is undeniable (see Kanter, 1983; Krueger, 1995, and Clark and Soulsby, 1995). One could even go further to certify that smooth implementation of the new policy is to a large degree dependant on their acceptability and desirability of the new policy (see Dobni et al, 1996 and Johnson et al 2000). This has motivated the researcher to assess the degree of acceptance of privatization and other related issues in the Egyptian context.

Two categories of managers were picked for the survey (senior managers and middle managers). As Clark and Soulsby (1995) say, they are the key players in institutional change. The managers were chosen according to a stratified sample in industrial and non-industrial companies.

The managers were grouped into four groups in an attempt to ascertain whether there were differences in attitude associated with type of business or level of managers. The four groups were:

- senior managers in Ics;
- middle managers in Ics;
- senior managers in NCs, and
- middle managers in NCs.

Analyses and comparisons revealed some differences among groups. However, most of the differences were not major. Although in different degrees, all manager categories admitted failure of SOEs in achieving their objectives, accepted the inevitability of privatization but were not very much looking forward to its application in their own companies. Many of them felt it was an inevitable Government policy, nevertheless they were reluctant to accept its immediate implementation. They could not deny that key success factors were more evident in the private sector but many of them still found advantages in public ownership and feared effects of privatization on unemployment levels and company systems. They also highlighted some problems that could be associated with privatization such as labour resistance, difficulty of valuation of SOEs, problems of dealing with past debts and ending up with two authorities to report to, the Government and the shareholders.

Although middle managers showed a higher level of acceptance compared to senior mangers especially in ICs, their responses showed that they feel strongly that the public sector is efficient and could be more efficient if problems of red tape and shortage of finance are solved. Senior managers were highly concerned with both finding buyers and valuation methods. Middle managers were more concerned with labour resistance and future work opportunities. Senior mangers whether in ICs or NCs had greater concerns about the legal framework and accuracy of the valuation procedures as compared to middle managers.

In conclusion, managers in all categories certify their acceptance of privatization, but warn of possible drawbacks. Senior and middle managers in NCs seem to be stronger believers in the public sector. A large majority of them assert its efficiency, but still admit that it hadn't achieved its objectives fully. In general, managers of ICs seemed more prepared for the transfer to private sector as compared to NCs, especially amongst middle managers. Senior managers in both types of companies stressed the fact that they accept privatization, but were not looking forward to applying it in their own companies. They were satisfied by the accompanying restructuring procedures. Overall the middle managers in both types of companies seem to accept sale of SOEs more than others.

## 11.4 Final Conclusion

The experience of Egypt in implementing privatization so far has been partly successful. The speed of implementation has not matched expectations. Serious problems were encountered, especially in labour, valuation and restructuring areas.

Doubts have been raised regarding the genuine commitment of policy makers and managers of SOEs to privatization. The slowness of implementing privatization is attributed to both lack of commitment and inadequacy of management. Accountability for low levels of success is not clearcut. Since managers' attitudes to privatization are so important a good marketing plan to create or enhance favourable attitudes is essential.

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❖ **List of Interviews**

- Interviews at the Public Enterprise Office (PEO)
  - Interview with Mr. Mamdouh Salem Deputy of Public Enterprise Minister, 17th October, 1995.
  - Interview with Dr. Fouad Abdel Wahab, , Chairman of PEO, 19th Sept., 1995.
  - Interview with Mr. Mohamed Hassouna, Deputy Chairman of PEO (22nd Sept., 1995).
  - Interviews with several Personnel at the PEO.
- Interviews with Stock Market personnel:
  - General Manager of Stock Market, 6th June, 1993
  - Mr. Ashraf Mohamed, Financial Department, Stock Market 7th June 1993
- Interviews at the Social Fund
  - Interview with Mr. Omar El-Farouq, General Manager of the Social Fund for Development
- Interviews with Brokerage Company Managers:
  - Mr. Ayman Ibrahim, Chairman of Petco Company for Stock Exchange, 8th April, 1997.
  - Dr. Ibrahim Mokhtar, Chairman of El-Rowad Company for Stock Exchange, 9th March, 1998.
  - Mr. Mohamad Mokhtar, Manager of El-Rowad Company for Stock Exchange, 10th March, 1998.
- Interview with Capital Market Authority officialials, J - A number of officials were intervid

  the stock market in the period 1991 to 1997.
  - Several representatives of the pricing committee were also interviewed to find out the procedures of pricing and the accompanying problems.
- Several interviews were made with a number of businessmen about their willingness to invest in SOEs and different valuation problems.