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**Hand in Hand: Privatising five star hotels in Egypt through the stock market will enhance the latter's role as well as set an example of the benefits that could be gained from privatisation.**

SHAHIRA ABDEL SHAHID

Doctor of Philosophy

The University of Aston in Birmingham

September 1992

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THE UNIVERSITY OF ASTON IN BIRMINGHAM

**Hand in Hand: Privatising five star hotels in Egypt through the stock market will enhance the latter's role as well as set an example of the benefits that could be gained from privatisation.**

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This thesis examines the possibility of privatising public owned five star hotels in Egypt through its stock market in order to give a boost to the Egyptian privatisation programme and to help activate its stock market. To explore these aspects, two main technical exercises were executed. First the writer constructed for the first time in Egypt a daily price index for Cairo Stock Exchange and an index for the tourism sector, in order to analyze the efficiency of the capital market. This technical analysis showed that Cairo stock exchange is inefficient, stagnant and undergoes minimal fluctuations, especially when compared to other developed and emerging markets. Second given the importance and complexity of the valuation of SOEs prior to their privatisation, a sample of three five star hotels that could be prime candidates for privatisation via the stock market in Egypt were selected and a detailed financial analysis for the three hotels was concluded. The result was a valuation range for the three hotels using various valuation methods. Nevertheless it was found out that the final value of hotels will be determined by the market itself. Despite the inefficiency of Cairo Stock Exchange, the thesis did not rule out privatisation through the stock market. On the contrary it cited several examples of developing countries that were able to successfully privatise some of their SOEs via their rudimentary capital markets. Finally the thesis recommended that five star hotels could be perfect candidates for privatisation via the stock market in Egypt. This is because five star hotels are profitable, privately managed, non strategic and not highly capital intensive businesses. In addition they do not suffer from overstaffing and the industry in which they operate i.e. tourism sector has high growth prospects and is of an international nature. Therefore it is anticipated that privatisation of five star hotels can attract a lot of investors because of the relatively high returns. This in turn will help activate and popularize the capital market in Egypt. At the same time the benefits of privatisation would be more visible which will give more momentum to the privatisation programme and make it more politically acceptable.

KEY WORDS: PRIVATISATION IN EGYPT; EGYPTIAN TOURISM INDUSTRY; VALUATION OF EGYPTIAN HOTELS; EGYPTIAN STOCK MARKET.

## DEDICATIONS

**To Anba Bishoy:** whose love, prayers and help are guiding me through every step in my life and in particular through every line in this PhD.

**To my father:** to whom I owe everything and to whom this PhD is primarily dedicated. Papa, given your expertise and qualities, I strongly believe you deserve this PhD more than I.

**To my mother and Nevine:** whose love, prayers and encouragement have been accompanying me ever since I left them.

**To Abouna Yohanna:** whose prayers, love and patience were the main driving force behind the start and the completion of this PhD.

**To my grandmother:** who is so loving and caring and has always been praying for me. I love you and hope you feel better.

**To Katayoun and Gelareh:** your love and friendship are a great blessing that came into my life, without which, my stay here would have been intolerable.



## ACKNOWLEDGEMENTS

First of all, I thank God, because without His Will, this PhD could not have been done. Also I thank Saint Mary and all the Saints for their prayers and help.

My sincere gratitude to Prof. E. Davis and Mr. R. Buckland, my supervisors, for their great guidance, support and encouragement all throughout this PhD.

My sincere thanks to Dr. K. Sherif for sending me documents from the World Bank, Dr. H. El Sherif for providing me with the accounts of five star hotels in Egypt, the Cairo Stock Exchange officials for allowing me to photocopy trading data from their records and finally Dr. Hassanein, Dr. Hatem, Mr. Kolta and Mr. Fouda for their valuable comments.

Further special thanks to the various financial consultants, and hotel managers that were interviewed both in London and Cairo. Their invaluable views and insights have definitely enriched my knowledge about valuation.

My sincere gratitude to Dr. Beblawi, Chairman of the Export Development Bank of Egypt, who has generously granted me education leave for three years and protected my job. He took this unusual step in a rare display of support for higher education, which is uncommon with employers in Egypt.

Also many thanks to Hala, Gihan and Hassan for helping me with the programming task.

My deepest thanks to my mother who helped me in the tiresome task of inputting the data into the computer as well as sending me all the required information from Egypt concerning my topic.

A lot of thanks to my colleagues Duan and Santrupt for their help and good friendship. I wish them all the best in their work..

Finally I am deeply grateful to Anba Missael, Ashraf, Heba, Heidi, Enas, Nashwa, Tant Fawziya, Tant Thoriya, Tant Karima, Tant Soad, Dr. Mary Mena and everyone who has supported me.

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## Abbreviations

B/P	= Balance of payment
SOE	= State owned enterprise
SOEs	= State owned enterprises
JVEs	= Joint venture enterprises
GOEs	= Governorate owned enterprises
AID	= U.S. Agency for International Development
GDP	= Gross Domestic Product
GNP	= Gross National Product
IMF	= International Monetary Fund
IFC	= International Finance Corporation
FFEM	= Free Foreign Exchange Market
L.E.	= Egyptian Pound
GIT	= Group Individual Traveller
Alex	= Alexandria
CSE	= Cairo Stock Exchange
OTC	= Over the Counter or off exchange trading
CMA	= Capital Market Authority
SEM	= Stock Exchange Members
P/E	= Price Earnings ratio
DCF	= Discounted Cash Flow
NPV	= Net Present Value
EPS	= Earnings per share
CAPM	= Capital Asset Pricing Model
APM	= Arbitrage Pricing Model
YP	= Years Purchase
M.O.D.	= Minor Operated Departments
Tel	= Telephone
Tlx	= Telex
CASI	= Cairo All Share Index
TI	= Tourism Index
CAPMAS	= Central Agency for Public Mobilisation and Statistics



## **Chapter 1    Introduction**

By the 1990's, privatisation as a concept had swept the whole world. The main reason that made privatisation widespread and popular was the dissatisfaction of various governments with the inferior performance of their public sector. Likewise the Egyptian government faced the same dilemma. In an attempt to enhance the role of the private sector and reduce the burden of its public sector, the Egyptian government has embarked on an economic reform programme in 1990 out of which, privatisation, has been opted as one of the solutions for the state owned enterprises i.e. SOEs in Egypt. Further the Egyptian government has announced that one of the reasons for undertaking privatisation is the revival of the role of the stock market in Egypt.

Given the importance of privatisation for Egypt at the current period as well as the writer's interest in the Egyptian stock market, she decided to choose a research topic that embraced both themes i.e. privatisation and the stock market in Egypt. From here originated the main purpose of this thesis i.e. to examine the possibility of privatising publicly owned five star hotels in Egypt via its stock market.

**Chapter one** presents a short synopsis of the contents of each chapter in this thesis.

**Chapter two** introduces the concept of privatisation. It then discusses its importance, advantages, drawbacks and rejoinder to those drawbacks. Afterwards the U.K. experience with

privatisation is presented in summary form. The chapter subsequently provides examples of developing countries that adopted privatisation, with reference to the activities being privatised, the methods of privatisation used and the problems encountered. Next the chapter points out to some developing countries that were able to successfully privatise their SOEs via their rudimentary capital markets. Finally it was possible to produce a checklist that included twelve conditions that should be present to make privatisation work.

**Chapter 3** discusses in detail the problems facing the SOEs in Egypt and their impact on Egypt's national budget, balance of payment, national debt etc.. Then an analysis is conducted into the reasons behind the substandard economic performance of SOEs. Several recommendations are then proposed in order to enhance the performance of SOEs in Egypt. Finally the chapter examines whether privatisation could be a solution for SOEs problems in Egypt or not.

**Chapter 4** addresses the question: which sectors in Egypt should be privatised first? To answer this query, the writer referred to the experiences of other countries in their choice of SOEs to be privatised. Then the chapter quoted to the Egyptian government's proposed privatisation programme and the criteria to be used in indentifying suitable candidates for privatisation. Given that, it was clear that the tourism sector will be one of the earliest to be privatised in Egypt, and within that sector, five star hotels will be privatised through the stock market. Subsequent analysis within this thesis focused upon this theme. The remainder of the chapter



considered the merits of privatisation of Egyptian hotels by reference to their distinctive characteristics. It was found out that five star hotels will not only be attractive investments to local investors but also they would attract international investors due to the competitive edge that Egyptian hotels enjoy when compared to five star hotels abroad.

**Chapter 5** addresses the valuation issue, which is one of the crucial factors that has to be determined prior to any privatisation. The chapter first discusses the importance of value and its various concepts. Next the various valuation methods used by financial consultants are presented. Then the critical factors that affect any valuation exercise are mentioned. Finally the chapter ends by mentioning the main problem areas encountered in any valuation exercise.

In **Chapter 6**, a specific valuation exercise was concluded for three hotels in Egypt i.e. Cairo Marriott, Cairo Sheraton and Aswan Oberoi, after an intensive investigation into their accounts. In the end it was confirmed that the value of any firm will be determined by the market i.e. buyers and sellers deciding on the price. The valuation exercise acts only as a bench mark for the final price. Nevertheless it serves to both illustrate and critically examine a process necessary for subsequent privatisation through the stock exchange. Since valuation is a complex matter and little has been written about it from the practical point of view, the writer made use of various personal open-ended personal interviews as well as telephone interviews with a group of well known financial consultants in Cairo and London. These interviews have enriched



the writer's knowledge of the subject and helped her in conducting the valuation exercise for the three hotels.

In **Chapter 7** of the thesis, an overview of the functioning and operations of the stock exchanges in Egypt was given. Then the writer created for the first time a daily price index for the Cairo Stock Exchange and an index for the Tourism Sector. From the constructed indexes besides other technical analysis, it was found out that the capital market in Egypt was inefficient and stagnant. This was confirmed when Egypt was compared to other developed and emerging markets.

**Chapter 8** discussed in detail the prerequisites that should be present if Cairo Stock Exchange is to be efficient. They comprise: the existence of profitable companies whose shares are frequently traded; well informed investors that have the necessary savings to invest in shares; sophisticated financial institutions; skillfull market makers and brokers, accurate and updated information and finally the regulatory framework should promote and encourage share investment.

In **Chapter 9**, it was pointed out that despite the inefficiency of the Cairo Stock exchange, it is feasible to privatise five star hotels through the stock market in Egypt, as has occurred in the case of other industries in developing countries. Privatisation of five star hotels in Egypt through the stock market will enhance its role as well as give a boost to the privatisation programme. It should be mentioned that the writer has again conducted various interviews with brokers, Capital Market officials and other experts in this field which helped her in the analysis of this chapter.

In conclusion the thesis indicated that there is a two way relationship between privatisation in Egypt and the stock market. In other words privatising five star hotels through the stock market will be beneficial for the privatisation programme in general as well as for reviving the role played by the stock market in Egypt. Finally the limitations of this thesis were mentioned.

## **Chapter 2    Privatisation: An Overview**

### **A. Introduction:**

The chapter will first start by presenting the two controversial views concerning the importance of the roles of the public sector versus that of the private sector. Next a formal definition of privatisation will be given. Then a short summary will be furnished of the criticisms attached to privatisation and the answers to those criticisms. Afterwards the chapter will briefly refer to the U.K. experience with privatisation. Following experiences of twenty developing countries with privatisation will be examined. Then the chapter will point out to examples of developing countries that were able to successfully privatise their SOEs via their weak capital markets. Finally the chapter will end by specifying the lessons that could be learnt from those countries, with regard to privatisation.

### **B. Development Economics versus Free Markets view:**

The dominant view in development economics was that markets failed to work efficiently in less developed countries so there was a need for active state intervention to offset these market failures. The main objective behind state intervention was to protect infant industries, control private monopoly power, cross subsidize to offset the tendency to concentration, protect employment and maintain macroeconomic balance. However during the 70's and 80's there was much concern about the interventionist approach to development that was



accompanied by expansion of the public sector. Slow growth, lagging private savings and investment, high inflation, B/P deficits, heavy debt burdens, widespread inefficiencies, resource misallocation and corruption were seen as the consequence of excessive growth in the public sector.

Therefore in the 80's and early 90's, dissatisfaction with SOEs in both developed and developing countries resulted in a policy prescription involving an increased role for the markets and price mechanism.

This requires a strategy of economic liberalization i.e. removal of various forms of government intervention in product and factor markets that are seen as distorting, so that their removal will ensure economic efficiency. From here has risen the surge for privatisation, first in developed countries which was later exported to developing countries, as one of the routes to solve their SOEs' difficulties. Consequently, public sector reform encompassing privatisation has become a very integral element in the conditionality attached to the World Bank and IMF lending programmes to developing countries. According to Letwin (1988), these international agencies have been advocating privatisation as a useful tool to reduce fiscal demands and increase the vitality of the private sector.

Before we argue whether privatisation is advantageous or not, we will first define privatisation.

### **C. Definition of privatisation:**

Wilding (1990) defined privatisation as the desire to strengthen and expand the market at the expense of the state and increase the exposure of the public sector to market

forces. It is denationalization and liberalization of public enterprise. It is also aid to the private sector as a deliberate policy to attract it to certain fields of work. Further it concerns reductions in state provision, state subsidy and regulation.

In addition Cook and Kirkpatrick (1988) indicated that privatisation is used to describe a range of different policy initiatives designed to alter the balance between the public and private sectors. The first and most common usage of the term refers to a change in the ownership of an enterprise from the public to the private sector. Denationalization or divestiture can proceed in different ways i.e. sale of all/part of privatised enterprise equity to the public, in case of developed capital markets; sale of the enterprise as a complete entity where capital markets are rudimentary or it can take the form of joint ventures which introduces a private sector involvement into the public enterprise. A second mode of privatisation involves the liberalisation or deregulation of entry into activities previously restricted to SOEs. This will increase competition between the private and public sector even though there is no transfer of ownership of assets. A third type of privatisation is where the provision of a good/service is transferred from public to private sector but the government retains the ultimate responsibility for supplying the service eg. franchising or contracting out of public services and leasing of public assets to the private sector. A final and extreme type of divestiture is the formal liquidation of an SOE.



In summary privatisation reflects a political commitment to roll back the public sector and to free market forces, hence it entails the following three acts:

1. Transfer of ownership and management from public to the private sector.
2. Encouragement of the private sector where it exists alongside the public sector.
3. Reduction in the government intervention in terms of regulation, subsidies and planning.

**D. Advocates of privatisation:**

- 1. The public sector serves the bureaucrats' needs rather than its customers:**

According to Pirie (1988) the public sector is producer oriented. Hence it is directed to serving the values and meeting the needs of those who direct and work within it. The legislators and the bureaucrats make the decisions which determine its outcomes reinforced by more pressure from the workforce which produces its goods and services rather than from the public which consumes it. On the other hand he indicated that the private sector is characterized by risk taking and by the allocation of resources towards those who are successful at meeting consumer requirements. He added that private sector operations outperform their public counterparts since they are subject to economic disciplines not present in the state sector and they respond to choices made by consumers. Finally he ended his argument by saying that though the word "public sector" embraces public ownership of state industries, in practice most of the attributes of ownership are exercised by those who administer. Hence the public may own the assets

in the sense of a name whereas the right to determine use, to enjoy benefits, to transfer and to alienate are all denied. Thus in the real sense of the word, the publicly owned industries are effectively owned by their administrators.

## **2. The failure and losses of the public sector:**

In many countries, developing and developed, the performance of the public sector has not met expectations but instead has become a drag on the economy and a drain on the Treasury. Mohanna (1987) stated that SOEs today share common characteristics: demands for continuing subsidies, weak performance, operating losses, huge budgetary deficits and utilizing scarce resources inefficiently. Further Dytianquin (1985) mentioned that economic inefficiency in the production activities of the public sector has been manifested by high production costs, inability to innovate and costly delays in the delivery of goods and services. To augment these problems, the government tried to compete in areas of business activities previously handled by the private sector which increased market distortions and discouraged private sector involvement.

Concerning the U.K. case, Grimestone (1988) indicated that the performance of nationalized industries was generally disappointing, in particular, their low return on capital employed, low productivity, high manpower costs and the low level of customer satisfaction. In addition Lamont (1988) stated that the British nationalized industries increased the burden on the tax payer.

Continuing with the same line of argument, Lee and Nellis (1991) cited that despite the differing circumstances of



socialist countries and the diversity of their public sector, they are dissatisfied with their SOEs. The main reasons were: production was frequently achieved to the exclusion of cost considerations, quality of the produced items was poor and they tended to operate below existing technology frontiers.

Finally the World Bank Report (1992) mentioned that many SOEs in various countries have been economically inefficient and incurred heavy financial losses. For example between 1989 and 1991, SOEs' losses as a percent of GDP reached 9% in Argentina, 8% in Yugoslavia and 5% in Sub-Saharan African countries. In the 80's, about half of Tanzania's SOEs made losses, in 1991 about 30% of all SOEs in China were loss making and in Turkey, the marginal efficiency of an SOE capital is half that of the private sector.

In summary the experience with SOEs proved that they were inefficient, overstaffed and their borrowings represent a substantial amount of the foreign debt.

### **3. Privatisation enhances efficiency:**

One of the chief goals behind privatisation is to improve efficiency. Mulley and Wright (1986) stated that the public sector may not satisfy consumer needs because there is no notion of bankruptcy in the public sector. The problem is aggravated by the political interference of the government in the decision making process of its SOEs. Both factors lead to inefficiencies in the SOEs. On the other hand they argued that private ownership is more likely to improve efficiency especially if there is competition in the product market.

Furthermore Beesley and Littlechild (1983) stressed that



privatisation will generate benefits for consumers because the discipline of the capital market allocates resources as consumers dictate not according to the wishes of the government. For example the U.S. experience showed that private enterprises were more efficient and productive than public enterprises. According to Mohanna (1987), the evaluation of the U.S. government's building maintenance service revealed that the government employed about 17 times as many people and spends 14 times as much as private firms to perform the same service. Further the U.S. railroad company, Amtrak, repaired 182,955 railroad ties with an average crew of 69, while the private firms repaired 684,338 ties with an average crew of only 26.

On the other hand Grimstone (1988) pointed out that the performance of privatised companies in the U.K. improved drastically. British Aerospace have trebled its profits, Cable and Wireless profits were up sevenfold, Amersham's profits have doubled, Jaguar's were up a third and the National Freight Corporation have increased sevenfold. Similarly the World Bank Report (1992) mentioned that a study of 41 firms fully or partially privatised by public share offerings between 1981 and 1989 in 15 countries (primarily developed but also including Chile, Mexico, Jamaica and Singapore) showed substantial efficiency gains. Once privatised those firms increased returns on sales, assets and equity; improved internal efficiency by better utilization of physical and human resources; improved their capital structure; increased capital expenditure and marginally increased their work force due to higher investment

and faster growth.

#### **4. Positive fiscal impact of privatisation:**

Grimestone (1988) remarked that besides the cash proceeds from selling nationalised industries in the U.K., privatisation produced continuing cash benefits to the Exchequer in terms of increased tax payments made by the privatised companies as their profitability increased, interest savings made by the government on the debt foregone as a result of selling equity and dividends from residual shareholding. Moreover Santini (1988) said that the French government gained 67 billion Francs from privatisation which exceeded its forecasted revenues of 30 billion Francs. In turn the state has used the extra income in reducing the public sector debt as well as increasing the capital expenditure in the form of grants to public companies. In addition Jones (1991) reported that in New Zealand the sale proceeds from privatisation were used to reduce the government's deficit by reducing its debt. Furthermore the World Bank Report (1992) stated that in Mexico, the government transfers to SOEs at the end of 1988 were down by 50% due to privatisation. In Chile, its privatised electricity company paid more taxes to the government, whereas in Argentina, its privatised telephone company paid \$100 million more in taxes in the first year after its sale.

#### **5. Wider share ownership or popular capitalism:**

Another important goal of privatisation is to sell large amounts of state enterprises to private owners which has eventually led to wider dispersal of wealth both through the direct encouragement to employees in privatised companies to



purchase shares and through selling to the wider investing public. Referring to the U.K. experience, Lamont (1988) pointed out that extending share ownership both gave people a stake in the success of British industry and contributed to the success by helping small investors to understand their own role in the process of wealth creation. He added that the British government encouraged employee share ownership which has resulted in about 1300 employee share schemes that meant that a million and a half employees have a direct interest in the success of their companies. Moreover Coyne and Wright (1982) proclaimed that employee share ownership improved the performance of the companies because of the greater incentives that employees gain as they become owners of the businesses. Further Grimestone (1988) remarked that as a result of mass privatisation in the U.K., one in five of the adult population has become a shareholder compared to one in ten in France and one in twenty in Japan. In addition, 90% of the workforce of the companies that were privatised took up the bonus and other share offers that were given to them. Finally he concluded by saying that privatisation in the U.K. provided depth and capacity to the capital market by virtue of the size, importance and market dominance of the nationalised industries. The same was encountered in the French privatisation programme. Maclean (1988) disclosed that about 1.5 million small investors rushed to take advantage of the public offer for sale of Banque National de Paris where demand exceeded supply by 14 times. Also 3.8 million investors bided for the shares of Paribas. The public response was so overwhelming that for every ten shares

solicited, it was possible to allocate only four. The Paribas phenomenon made popular capitalism a reality in France. In addition Redwood (1986) referred to the British Columbian experience whereby the government offered free shares of British Columbian Resources and Investment Corporation to all adult voting population of the state. The issue was a great success with a very high proportion of the public taking up their free shares and very many subscribed for additional shares. The experiment demonstrated that a government offer for sale coupled with a free share issue can reach individuals who would not otherwise contemplate buying shares on the stock market and gave considerable support for the privatisation programme. Finally the World Bank Report (1992) mentioned that privatisation has helped develop and expand financial markets in Jamaica, Chile, Nigeria, U.K., Japan and France, which will be discussed in detail in chapter eight.

From the above, one can view that advocates of privatisation are opposed to the interference of the government in running enterprises since it does not satisfy the needs of consumers and because public ownership tends to result in huge losses and inefficiencies in the public sector. Such advocates further argue that privatisation enhances efficiency, increases the government revenues and promotes wider share ownership.

#### **E. Opponents to privatisation:**

##### **1. The market economy is not necessarily better than the public sector:**

Wilding (1990) pointed out that the assumption that in market situations the consumer has much power neglects the idea that he/she can only buy what is available. He added that the



assumption that the private sector management is superior is not a universal panacea. He concluded that the assumption that freedom is enhanced when individuals buy and sell goods in market relationships, oversimplifies complex issues such as the nature of freedom, the value and significance of what is being provided and whether and how it would be provided by the market. These are all important considerations that are lost in ideological generalizations. Further those against privatisation claim that the efficiency gains are not conditional on privatisation i.e. the internal reform of the public sector is an alternative option for realizing the same gains. Hence the World Development Report (1983) remarked that the key factor in determining the efficiency of an enterprise is not whether or not it is publicly or privately owned but how it is managed.

## **2. The public sector has multiple conflicting objectives:**

Dytianquin (1985) remarked that the establishment of SOEs could be rationalized on the basis of ideological, nationalistic, economic and social grounds. Under ideological motives, state involvement in industries has been justified as control of the "commanding heights" or vital sectors that if left in private hands could not guarantee socially responsible performance. Nationalistic objectives would include the achievement of self-sufficiency, the enhancement of national prestige, the maintenance of sovereignty over natural resources. Economic objectives for government involvement in business would include domestic resource mobilisation, the preservation of employment levels, establishment of industries

that require large capital investments which are beyond private financing due to their high risks and underdeveloped capital markets, the infant industry argument etc.. Finally social considerations in support of public enterprises would include the prevention of economic concentration in the hands of a dominant few, income redistribution i.e. to prevent the accrual of monopoly rents and undue profits in few private firms and to provide goods and services at affordable prices.

Also Sato (1985) justified the non profitability of SOEs because a large number was established to engage in activities where private enterprises cannot operate profitably. Hence SOEs are burdened with extra social costs which need to be compensated by fiscal support in the form of equity, credits at preferential interest rates. He added that public enterprises are granted monopoly privileges by the government and therefore they are not subject to the competitive pressure of market forces which is fundamental to organisational efficiency. Finally he said that SOEs lack autonomy from government control which undermines management accountability since any financial loss could be compensated for by government funds. In conclusion Heald (1984) emphasized that since SOEs have multiple conflicting goals, they will fare relatively badly when their performance is evaluated on a single criterion with the private sector. Hence comparisons without reservations between the public sector and the private sector on the basis of relative cost and efficiency is irrelevant.

### **3. Financial disadvantages:**

According to Letwin (1988), one of the main objections to



privatisation in the U.K., which was also cited in other privatisation programmes over the world, is the sale of the family silver or give away of public assets that could never be replaced at very low prices. Maclean (1988) pointed out that the deliberate undervaluing of French privatised companies has guaranteed their sale but has provoked accusations of selling off state assets on the cheap. Also Jenkinson and Mayer (1988) mentioned that the phenomenon of underpricing in both the U.K. and French privatisations was associated with wider share ownership.

In addition Cook and Kirkpatrick (1988) explained that the immediate effect of asset sales of a profitable SOE will be a once and for all reduction in the government deficit, if the sale was correctly priced. However if the price was set too low to favour the purchasers, then the public sector net worth is reduced. If the government used the sales revenue to reduce taxation or increase expenditure, then the deficit in the sale year remains unchanged but is increased in following years. Whatever the use made of the sales proceeds, the resulting change in the current overall deficits fails to reflect the macroeconomic consequences of the sale in the medium term.

Moreover Commander and Killick (1988) commented that if SOEs are profitable then the rationale for divestiture becomes less obvious if reduction of public deficit is the goal but rather it becomes the virtues of private ownership.

On the other hand, in case of selling losing enterprises, Mohanna (1987) mentioned that governments can rarely find buyers at mutually acceptable prices and therefore they have

to offer lump sum subsidies to buyers which will have an insignificant impact on the public finances. Further Henley (1991) indicated that in order to attract private buyers for ailing SOEs, it may be necessary for the government to offer sweeteners in the form of protection from competing imports or tax breaks. Thus high effective rates of protection will undermine economic efficiency.

In short, the government is likely to face a policy trade-off between efficiency and financial objectives. The sale of an SOE will be easier and revenues will be higher if the privatised firm was offered market protection, but economic efficiency will be adversely affected and vice versa.

#### **4. Monopoly disadvantage:**

Privatisation is widely advocated because it will lead to increased efficiency. Yet, Mansoor (1988) argued that significant efficiency gains are more likely to result from measures to increase competition than from changes in ownership. As observed by Kay and Thompson (1986), a government that is concerned with maximizing the revenue obtained from the sale of public assets could not be expected to support competition. Thus increases in earnings that arise from restrictions to competition have no obvious relation to ownership and could be achieved without privatisation.

A number of authors Chiplin and Wright (1982), Beesley and Littlechild (1983), Kay and Silberston (1984) and Shackleton (1984) have emphasized the importance of competition and argued that privatisation should be seen as part of a package for promoting competition and not as the sole means of trying to



achieve it. Also Sharpe (1984), Vickers and Yarrow (1985) confirmed that if after being privatised, companies remain in an environment of excessive trade protection and government intervention, which is a transfer of a monopoly from public to private hands, privatisation will generate minimal gains.

In addition Beesley and Littechild (1983) stressed that a privately owned company will have greater incentive to exploit monopoly power commercially and thus consumer benefits could be lesser from privatisation than they might be. Thus the Economist on 21/12/85 argued that privatisation in the U.K. considered raising money more important than promoting competition which meant that consumer benefits were reduced in favour of getting a higher revenue for the U.K. Treasury.

Moreover Bret (1988) remarked that since emerging domestic markets size are too small to permit only a very limited number of producers; thus given the opportunity to exploit monopoly power, private firms will be the same or even worse than SOEs.

In short to make public enterprise attractive to buyers and maximize short term receipts from sale, governments will under pressure grant privatised company monopoly powers that reduce efficiency gains that were originally intended from the transfer of ownership, which is an unresolved problem.

#### **5. Distribution disadvantages:**

According to Commander and Killick (1988), there are various distributional impacts of privatisation that could not be neglected. They comprise the following effects:

- If SOEs were used to subsidize consumers then the previously subsidized prices will be swapped by market determined prices

which will definitely create a group of losers since consumers will not afford to buy the service now due to the higher prices.

- Since SOEs are characterized by overstaffing, therefore the short term effect of privatisation is to reduce employment.
- If benefits of reduced costs incurred by the privatised company are retained by the new owners i.e. not passed to consumers, this will cause increased inequalities in the size distribution of income.
- If shares of privatised companies are sold to an already wealthy elite, this will aggravate wealth inequalities.

#### **6. Deregulation disadvantages:**

Sometimes governments would revert to deregulation in order to improve the performance of SOEs because they are now competing with the private sector. If the public sector is a natural monopolist with extensive market power, deregulation is unlikely to produce the desired increase in competition. This was illustrated by Cook and Kirkpatrick (1988), by the fact that the public sector might engage in anti competition to prevent rivals (private sector) who want to enter by reducing prices below cost. Hence deregulation should be accompanied by new regulatory mechanisms to control anti competitive behaviour. As Heald (1984) pointed out, paradoxically denationalization may lead to a substitution of regulation over the private sector for production within the public sector i.e. the demise of public production would be accompanied by the rise of regulation. Yet there is a big doubt about the effectiveness of those regulatory authorities in less



developed countries as well as in developed countries.

Hence Sharpe (1984) remarked that in spite of the fact that U.S. rates of return are controlled and there is a degree of publicity, formality and rationality about the regulation process, recently the magnitude of the costs of regulation, doubts about the accruing benefits, the associated tendency to limit competition and to restrict new entry, have caused a lot of doubt about the usefulness of these regulatory bodies.

The same problem was seen in the U.K. where the Economist on 25/12/85 argued that the independent regulation of a private monopoly is not necessarily better for consumers than a government owned monopoly. Therefore though British Telecom's average price rises must be 3% points below the rate of inflation, this has not stopped British Telecom from juggling the components of the average so that home subscribers pay more.

Likewise deregulation might lead to increased market concentration if protection against imports is reduced which forces domestic firms outside the market. At the same time since deregulation allows foreign firms to enter into the domestic market, it can be prohibitive to the infant industry argument that requires protection in order to let domestic firms become more competitive through time.

In conclusion, Cook and Kirpatrick (1988) declared that enthusiasm about the positive outcomes of privatisation should be regarded with caution. They cited that the results of the liberalization programmes in Latin America in the 70's and 80's have deviated significantly from the theoretical predictions.

It has been argued that the advocacy of simultaneous deregulation of all markets fails to recognize that the speed of adjustment in various markets differs. Other commentators have said that liberalization reforms were implemented when the economy was in serious macroeconomic disequilibrium with high inflation and severe foreign exchange shortages. Besides a sudden deregulation of markets is not at all an optimal solution. Hence opponents to privatisation believe that future privatisation in developing countries will be limited because of the above mentioned difficulties. Nevertheless they argue that public sector reform will be the predominant focus of developing countries in the next era.

#### **F. Rejoinder to the criticisms concerning privatisation:**

In this section we will discuss the criteria for undertaking privatisation.

##### **1. Privatisation is a cost benefit exercise:**

Beesley and Littlechild (1983) said that each privatisation should be studied in terms of a cost benefit analysis. Therefore one should evaluate the effects of each alternative privatisation proposal on different interest groups such as existing and potential consumers, tax payers, suppliers of labour and capital etc.. Trade-offs between these interest groups could be established and decisions made accordingly. Privatisation schemes should be designed to maximize net consumer benefits measured primarily by lower prices and improved quality of services rather than stock market proceeds.

##### **2. Privatisation should be accompanied by competition and deregulation:**

Mulley and Wright (1986) said that deregulation is intended to



increase competition through an increase in the number of competitors and by reducing possibilities for entry-detering behaviour. In addition Jones (1991) stressed that privatisation will be most successful if deregulation and competition accompany it, in order to prevent privatised concerns from exploiting a monopolistic position. In other words, privatised markets should be contestable: existing firms are vulnerable to entry by other firms, all firms have access to the same production methods and entry does not involve sunk costs.

Finally the World Bank Report (1992) asserted that in any privatisation the greater the degree of competition produced, the greater the likelihood that efficiency will be enhanced. It mentioned that critics of the early U.K. privatisations argued that it could have led to greater economic benefits had monopolies in potentially competitive sectors such as British Telecom, British Airways and British Gas, been broken up into smaller and comparable units before sale.

Therefore one can observe that generally speaking the economy will be better off if governments first deregulate potentially competitive activities and then later privatise, even if this means a lower sale price.

### **3. Solving for the non commercial objectives of SOEs:**

As mentioned earlier, the public sector has various diverse objectives. Hence if privatisation was undertaken, one should expect some groups to be harmed from the rise of prices. Mohanna (1987) insisted that market determined prices should be utilised and if they were high for certain groups who cannot afford to pay for the private goods and services, the

government has to make use of the voucher system to the needy. Further Beesley and Littlechild (1983) proposed that the government should study the social impacts of privatisation on certain groups. If it was found negative, explicit subsidies should be provided for the adversely affected parties. They added that generous redundancy payments should be made if large scale retrenchments were caused by privatisation. Though the above factors will constitute costs and will reduce the net benefits from privatisation, safeguards must be provided for the negatively affected groups, otherwise privatisation could be jeopardized.

#### **4. Solving the financial disadvantages of privatisation:**

According to Letwin (1988), the British government made use of the golden share to overcome public hostility against foreign involvement. Further the French government emphasized that the proceeds of privatisation will be devoted to the reduction of the national debt or increasing capitalization of the privatised companies, which cancelled the accusation that privatisation diminishes the stock of national assets. In addition Maclean (1988) mentioned that the French government established an independent committee for setting a minimum price for each privatisation. Of course this prevented any accusations of government corruption or that it is manipulating prices for political purposes.

#### **5. Creating a great interest group in privatisation:**

Letwin (1988) confirmed that by bringing a vast number of employees and small investors into the privatisation programme and making them shareholders of privatised companies, people



will not feel that privatisation is a menace but will rather consider it an opportunity to increase their wealth. In addition Carlisle (1988) argued that the main consideration prior to mass privatisation is to gain the public trust and confidence by offering them an attractive investment. He added that once the public is aware of the value of the investment offered to them, one can be sure of oversubscription. This however necessitates a well designed marketing plan to reach the targeted groups and convince them of the gains that could accrue to them via privatisation.

#### **G. Privatisation in the United Kingdom:**

Since the U.K. sets a concrete and extensive example of privatisation, a lot of literature has been written about privatisation in the U.K. in terms of its objectives, achievements, merits and disadvantages.

In this section however we will only present a short summary of what privatisation has succeeded in realizing within a ten year period 1980-90. The 1990 Report by the U.K. Treasury mentioned that before privatisation in 1979, the nationalized industries in the U.K. accounted for about one tenth of GDP, a seventh of total investment, employed nearly two million people and dominated the transport, energy, communications, steel and ship building sectors of the economy. Their performance has been consistently disappointing; criticisms have been voiced about their total return on capital employed, their record on prices, productivity, manpower costs and the low level of customer satisfaction they have provided. On the other hand, by the end of 1989, the picture had entirely

changed. About twenty nine businesses together with a number of subsidiaries of nationalized industries had been privatised and about 800,000 jobs transferred to the private sector. By 1991, the publicly owned commercial sector is likely to be around one third the size of 1979 i.e. state industrial sector is now under 4% of GDP. Receipts from privatisation up to 1990 totalled about £29 billion. Finally a share ownership survey by the Treasury and International Stock Exchange early 1989, indicated that there were about nine million adult share owners i.e. about 20% of adult population compared with about 7% in 1979.

In Table (2.1), the proceeds from privatisation in the U.K. throughout the period 1980-89 are displayed. Furthermore Table (2.2) presents the various methods of sale employed in the U.K. privatisation for the same period.

Concerning the disposal of SOEs, the U.K. experience is rich in this aspect because the U.K. government made use of various methods such as the stock market flotations, management buyouts, private deals to institutions and employee buyouts. Nevertheless, as shown in Table (2.2), Heald (1985) emphasized that in the U.K. the main mechanism has been the flotation of equity through an offer for sale whereby all or part of the public shareholding in the public limited company is offered for sale to the general public. He added that the technical problem encountered in stock market flotations was the use of fixed prices or tender methods. In the former, the price per share is fixed ahead of the flotation, whereas in the latter the eventual striking price depends on the balance between the



tenders made and the number of shares available. Under the fixed price method, there is the temptation to lower the offer price so that the whole issue is sold. As a result issues can be oversubscribed with the shares immediately trading at a premium. The resulting profits however are criticized on the basis that the method of sale has not ensured that the tax payers' interest has been protected due to the unnecessarily high administrative costs and market discounts as pointed out by Buckland and Davis (1984). On the other hand it is difficult to incorporate schemes of preferential terms for small investors if the tender method is adopted.

Therefore to evaluate whether privatisation was successful or not will depend on the objectives set by the government i.e. higher proceeds versus spreading share ownership. However the latter objective is difficult to achieve since a rapid reduction in the number of shareholders willing to subscribe beyond the receipt of marginal financial benefits from share purchase incentive schemes has been noted. Buck, Thompson and Wright (1991) mentioned that though a lot of inducements have been given to small investors in the U.K. privatisations, the number of shareholders has fallen. In addition Grout (1987) said that the proportion of the stock market owned by individuals in the U.K. is continuing its long term decline and that though privatisation has increased the number of shareholders, it will require other methods to deepen share ownership. Furthermore Goodison (1986) disclosed that a survey conducted by the Stock Exchange showed that 51% of shareholders have shares in only one company and a further 20% do not hold

shares in more than three companies. He therefore reasoned that it is a long way to go before one can say that shareholding has become a habit in the U.K. Finally the Financial Times in July 1990 disclosed that the percentage of private shareholders to total shareholders has continued to decline and was less than 20%. Hence from the U.K. experience, it can be viewed that though the government sacrificed revenues from the sale of its SOEs for the sake of wider ownership, the privatisation programme has not secured an increase in the percentage of ordinary shares owned by individuals.

This however does not mean that the stock market route should not be employed in the privatisation of SOEs in developing countries. Rather as stressed by Oyhenart (1991), stock market development accompanying privatisation is one of the means for sustaining economic growth in developing countries. Therefore developing countries should take advantage of privatisation as a means for promoting their stock exchanges and achieving wider share ownership. This entails that governments of developing countries devise mechanisms that reduce the after sale of shares by small investors following their price appreciation, (Cavazzuti, 1990).

#### **H. Privatisation in developing countries:**

As is well known, privatisation as a concept spread widely from the U.K. to many developing economies, though not as an interest in the ideology itself but rather due to the external pressures from international donors in favour of privatisation and due to the governments' dissatisfaction with the inferior performance of their SOEs.



Table (2.3) displays the diverse experiences of twenty developing countries with privatisation. The main aim is to illustrate the type/nature of activities that were privatised, the methods of privatisation employed, the reasons for having successful or/and failing privatisations and expected future privatisations.

It is worth noting that Egypt stands out in comparison to East European countries and so their privatisation efforts cannot be replicated to the Egyptian context. In those previously command-state economies, the state virtually controlled and owned key economic activities. Thus privatisation in East Europe is viewed as a complete ideological change towards the market economy. Yet privatisation in these countries is confronted with serious problems such as the lack of capital markets, lack of a private sector, lack of reliable and updated accounts, lack of savings, lack of managerial skills, lack of technology etc..

On the other hand, Egypt already adopts a system of mixed economy, has long established exchanges, since the early 1900's, and its private sector plays a vital role in its economic development. Though the current performance of the stock market in Egypt is not satisfactory, the possibility of privatising SOEs via the stock market route is feasible, a matter that will be analyzed in detail later.

#### **I. Examples of developing countries that successfully privatised their SOEs via their rudimentary capital market:**

In this section we are going to address a particular issue: is it possible to privatise SOEs in developing countries

through their weak capital markets?

Lately there has been controversies concerning the relationship between privatisation and the stock market. According to Letwin (1988), there have been many innovations to encourage the growth of stock markets and to open the way for privatisation by share sales. He declared that the privatisation process has brought to stock markets a new depth and volume. He further explained that a large number of new investors have been pulled into share ownership wherever it has been tried around the world. He concluded by saying that privatisation has turned out to be a powerful mechanism for popularizing stock exchange activities and for bringing a large number of new savers into the direct ownership of industry and commerce.

On the other hand there are views that stock markets cannot stand large privatisations. Vuylsteke (1988) reported that it has been argued that the level of development of the capital markets in a country will determine whether certain privatisations can be applied. Thus the specific method used in privatisation needs to be suitable to the structure and liquidity of the capital markets and the sophistication of the local investors. Therefore if there are no channels for share distribution and if the investing public is small in size, a traditional public offering of shares is deemed to be impractical. Letwin (1988) contradicted this citing various successful privatisations through the stock market. He mentioned that the capacity of the French market doubled in the first year of major privatisations. In addition the capacity of the London equity market has multiplied ten fold



over a decade of privatisation. Most interestingly the Jamaican stock market showed itself capable of expanding dramatically to undertake two major privatisations within a short period. He ended his talk by saying that it requires equity issues to increase the capacity whereas dealing capacity will usually expand to carry out the deals available. Financial capacity however will increase as the economy becomes more prosperous and as the total stock market grows.

Supporting the same view Vuylsteke (1988) asserted that based on the experiences of Jamaica, Kenya and two West African states with no equity markets at all, the prospects for raising local capital for privatisation, through public offerings that involved a broad section of the investing public, proved to be better than was previously thought.

Therefore the absence of a strong local capital market should not be thought automatically to preclude public offerings. On the contrary there are various measures that could be used by developing countries to compensate for the weaknesses of their capital markets.

The Jamaican Stock Exchange Report (1988) mentioned that prior to the National Commercial Bank (NCB) offering, most people believed that you cannot explain what a share is to people and that the stock market was a total enigma to most Jamaicans. At that time the Jamaican stock market had less than forty listed companies, had a thin and erratic volume of trading, was open for trading only twice a week for two hours per session and was dominated by few large institutions such as pension funds and insurance companies. Thus the government was confronted with

a formidable challenge of how to demystify the stock market. During the four months prior to the public offering of NCB, a coordinated publicity campaign that included T.V., radio, press conferences, special video briefings was executed. In addition more than 170,000 copies of the prospectus were made available two weeks before privatisation at post offices, supermarkets, local branches of banks and stockbrokers. The prospectus was accompanied by a four page document "Questions and answers about the share offering". This document posed and answered twenty of the most common questions about the stock market. It explained in clear terms the function of the prospectus, how to apply, how to pay, how the stock market functions etc.. It was distributed to 200,000 individuals, nearly 10% of the population. After the privatisation of NCB, the stock market was boosted by the substantial increase in capitalization and by the introduction of tens of thousands of first time shareholders. The offer was oversubscribed by 170% and demonstrated that liquidity was there and that the scope of the capital market can be significantly increased by sophisticated privatisation even in a developing country. As a result of NCB privatisation, the trading volume and value increased by 37% and 70% respectively, between 1988 and 1990.

Following the same line of argument, Turkey's first privatisation, the sale of government stock in the telephone equipment producer Teletas, was an outstanding success as pointed out by Turkey's privatisation debut (1988). The Teletas privatisation occurred in a time of high inflation, when the equity market was at its infancy and the business of share



ownership was not well understood. In short the government was trying to transfer over a century of financial development and experience into Turkey in one shot. In the Teletas privatisation, it was the first time nineteen Turkish institutions have formed a consortium to underwrite an equity issue; it was the first time securities were sold throughout Turkey's 67 states; and in many places it was the first time shares had ever been sold. The offer was accompanied by creative and massive distribution and publicity to compensate for the weakness of Turkey's capital market. The results were remarkable since the offer was oversubscribed by four times and 42,000 investors were shareholders for the first time. Further it has been argued that the satisfaction of investors made the privatisation process self perpetuating and the government has become more committed to make Istanbul Stock Exchange a viable source of corporate funding and investment. The Wall Street Journal on 9th November 1992 mentioned that Istanbul Stock Exchange has currently 75 actively traded stock with an index hovering around 4000. It added that about 3 million shares that were valued at \$16 million in January 1986 were valued at \$6.9 billion in January 1992. Further the ratio of stock market rights issues to Gross Domestic Savings has increased from 1.5% to 8% between 1989 and 1991. All these indicators reveal the growth that occurred in Istanbul Stock Exchange as a result of privatisation.

Luders (1990) indicated that all the divestitures of stock of SOEs in Chile which took place in the mid 80's, almost 50% were carried out at the stock exchange in the form of bids on small

and medium sized stock packages. As a result the total volume of trading at Santiago Stock Exchange rose from \$40 million in 1984 to \$650 million in 1988 and the transactions of stocks of privatised companies increased from 21% to 61% for the same time period. In addition divestiture of SOEs since the 70's till May 1988 brought 114,000 shareholders i.e. more than double the amount at the end of 1970. This number must have increased after the privatisation of ENDESA (Chilean telecommunication) in 1988. In short Santiago Stock Exchange became one of the most active in South America in terms of its total value to GDP, market capitalization to GDP and turnover ratios. Luders concluded that none of this could have happened without large divestitures of SOEs and the policy of spreading ownership of stock.

Faoro (1990) mentioned that it has been argued that privatisation was appropriate in India or Thailand, where there were markets, resources and infrastructure, but it will never work in poor countries. However the example of Honduras, the poorest country in Central America, which sold enterprises at an accelerated rate, proved that when something was offered for sale and was priced right, money appeared and there were resources even in less developed countries.

Further Vuylsteke (1988) quoted the example of the sale of shares to the public of Barclay's bank in Kenya, which was a sound and profitable private firm. The issue was seven times oversubscribed which included first time rural Kenyan purchasers. He continued by saying that the recent privatisations of industrial SOEs in Guinea called for



substantial shareholdings by Guinean investors. He added that in Bangladesh the sale of SOEs to the private sector helped in the growth of its stock market. Finally he remarked on the capital increase of Societe Togolaise de Side, which is leasing a steel mill from the government of Togo, achieved through a public stock offering. The issue of approximately \$1.3 million was subscribed by Togolese shareholders, including government officials, lawyers, business people, as well as the International Finance Corporation.

In conclusion Oyhenart (1991) pointed out that the success of privatisation programmes using domestic financial markets in developing countries depends to a large extent on the characteristics of those markets. She added while those markets may be weak at present, this should not be construed as an excuse to circumvent them and choose alternative means of divestiture which may appear more expeditious in the short term, but which do not lead to sustainable economic growth. Rather, the lack of a securities market should be looked upon as an opportunity to embark on financial market reform.

We end this argument by referring to what Walters (1985) stated about the relationship between privatisation and the stock markets in developing countries. He indicated that there is no point in complaining that organized local financial markets do not exist in many of the developing countries, because the process of raising funds for privatisation can be the vehicle for recognizing the existence of unofficial financial markets and an incentive to permit the emergence of an official capital market. In other words it provides an opportunity to create the

missing organized financial structures.

**J. Lessons learned from privatisation in different countries:**

As one can view from section (H), privatisation is not an easy or simple task to apply. Since it is a new concept introduced for the first time in developing countries, privatisation requires learning from all participants i.e. government, employees, management and the public at large.

However as governments gain more experience, one expects more benefits to be realized from privatisation. Therefore, despite the various obstacles that were encountered in implementing privatisation, it has worked out for a variety of settings such as Chile, Jamaica, Korea and Turkey. Also privatisation has worked out for poor countries. The World Bank Report (1992) gave several examples how privatisation was successful in poor countries. Thus privatisation in Niger turned around a textile company from a losing SOE to a profitable exporter. Also privatisation changed an SOE finance corporation in Swaziland that was loss making into a profitable private company after two years. Further an IFC supported privatisation in Mozambique made an SOE firm profitable.

The above examples clearly reflect that once properly executed privatisation can work out in various countries irrespective of their stage of development.

However for privatisation to be effective, there are certain conditions that have to be present which are:

1. Political commitment by the government to the privatisation programme is one of the key elements for its success.
2. Clarity about the objectives of privatisation is another



important condition for its success. Therefore the privatisation programme should be carefully planned and deadlines should be respected.

3. It is better to start privatisation with small and medium profitable SOEs in competitive sectors. Such sales are simple, quick, involve little restructuring and are politically low risk.

4. Public awareness campaigns are vital and critical in explaining the costs and benefits of privatisation as well as building a positive attitude towards privatisation as in the cases of Jamaica and South Korea.

5. Lay off of labour, as one of the main criticisms against privatisation, does not always accompany it. Thus the World Bank Report (1992) mentioned that privatisations in Mexico, Philippines and Tunisia led to increased employment. However in case of loss making and overmanned SOEs, it is better to handle this problem by the state instead of the buyers, since purchasers will ask for subsidies in exchange for taking a labour problem, which will reduce the efficiency gains from privatisation. Therefore it is better that the government gets rid of extra employees, but at the same time it should design measures to alleviate the social costs through retraining, severance pay, unemployment, insurance and other elements of the social safety net.

6. Putting in the right management in the privatised companies is vital for the future performance and profitability of those newly privatised companies.

7. Avoid heavy reliance on debt in the sale of shares of the

privatised company. In other words sale for cash is better than accepting debt even if it means a lower price.

8. Enterprise valuation is difficult especially in developing countries, where information is unavailable. While independent valuation will be useful in setting a floor price and assuring a fair process, it is better to let the market decide the sale price through competitive bidding. Further, governments should note that overvaluation can delay the sale of the enterprises while undervaluation is one of the first things that is criticized by the public. One solution to this problem is to have a high independent agency that reviews prices in the public interest as done by the French government.

9. The more one encourages various parties to participate in the offer of the shares i.e. local investors, institutional investors and foreign investors, the more one can secure a maximum price for the shares. The fear of foreign investors' interference could be solved by keeping a golden share for the government as pioneered by the British government.

10. Avoid having large scale privatisations during short periods in case of weak capital markets. Cavazzuti (1990) suggested that in thin markets there must be a proper flow over time between the quantity of new placings to avoid over-concentration in capital markets and failure of privatisation as in the case of Taiwan. However in section (I) it was shown that developing countries can have successful privatisations despite their weak capital markets.

Also before privatising SOEs through the stock market, be sure to inform first time shareholders of the risk/return involved



in this type of investment in order to avoid any future disappointments that might occur due to the volatility in stock prices. In addition if investors do not have adequate information about the stock market or which enterprises to invest in, mutual funds, unit trusts and pension funds should be established in order to bundle firms and diversify risks for investors as in the case of Poland and Czechoslovakia.

11. Transparency is essential in every privatisation. According to the World Bank Report (1992), this involves competitive bidding procedures, clear selection criteria for evaluating bids, disclosure of purchase price and buyer, well defined institutional responsibilities and adequate monitoring and supervision of the programme. On the other hand one expects that lack of transparency can lead to a perception of unfair dealing and public criticism that will not only threaten privatisation but also reform in general.

12. Privatisation will yield more immediate and greater benefits if it was part of an overall government programme of public sector reform as well as exchange rate, fiscal, trade and price reforms and a well functioning legal framework, (Nankani, 1990).

In the end one can conclude that though the privatisation implementation process have been troublesome in the majority of developing countries, governments are becoming more serious about it and have started to learn from their failures.

## **Chapter 3    Privatisation in Egypt**

### **A. Introduction:**

This chapter will address the question of whether we should privatise state owned enterprises i.e. SOEs in Egypt or not? In order to answer such a complicated and interrelated issue, a historical review of the different economic systems that Egypt has passed through before 1952 and to date will be given, with a special emphasis on the roles of both the public and private sectors in each period. Then the various categories of SOEs in Egypt will be presented. Afterwards a detailed analysis will be undertaken on the performance of SOEs in Egypt and their impact on the budget, credit, rate of return on capital and the B/P. Next we will discuss the reasons behind the poor performance of SOEs in Egypt. Then the chapter will propose solutions for improving the performance of SOEs in Egypt. Subsequently the chapter will answer the original question i.e. could privatisation be an option for solving SOEs problems in Egypt?

### **B. Different Economic Systems in Egypt:**

#### **1. The first phase (1930's - 1952)**

Between the period of the 30's and up till 1952 Revolution, although Egypt was ruled by the King, real power and control were in the hands of the British. During this period the economy was free and the private sector was dominant. Agriculture was the main activity of the country and cotton was its major export. As for local industry, it was



like Talaat Harb who founded the Bank Misr's group of companies in real estate, agriculture and marine industries.

Trade policy i.e. tariffs, import controls and exchange rate, had a determining influence on the evolution of Egypt's economic structure, particularly the composition of the industrial base. The key objective was to encourage domestic production and discourage imports through a system of trade protection. The trade policy imparted a serious bias against exports. During this period the private sector accounted for 87% of total value added and 95% of the total civilian employment whereas the public sector's role was restricted mainly to the provision of basic services eg. electricity, water, railways, civil administration.

## **2. The second phase (1952-1970)**

After the 1952 Revolution and during the 60's, under Nasser's rule, Egypt followed an economic policy which was based on socialist planning. In practice the government owned every economic unit worth controlling. Its policy included measures of agrarian reform, land reclamation and a programme of industrialisation which was accelerated by the formation of a comprehensive social and economic development plan. In pursuing the government's plan, all cotton exporting firms were nationalised. In addition 275 industrial and trading concerns were taken over by the state. Taxation was made so progressive that industrial income was virtually limited to L.E. 5000. During this period Egypt witnessed the emergence and growth of the public sector in replace of the private sector. Following the establishment of the Ministry of Industry in 1956, the

the establishment of the Ministry of Industry in 1956, the industrial sector quickly moved under state ownership. Soon afterwards the nationalisation of domestic financial institutions took place. Thus by the end of 1964, the state was in control of a considerable portion of the non agricultural sector of the economy. The only activity that the public sector did not assume direct control of production was agriculture. However the state intervened indirectly by limiting the size of individual holdings to 50 feddans in 1969; besides it formed a system of state supervised cooperatives coupled with an elaborate system of price controls.

### **3. The third phase (1971-1980)**

Since 1973, great efforts have been made to shift from an inward looking development strategy towards an outward oriented strategy and Sadat's law 43/1974 led to the replacement of the socialist planning by an open door policy that encouraged foreign investment and the private sector. The strategy did not however constitute a radical break with the past. Though joint ventures between the public and private enterprises were formed, the government continued to invest around 25% of GDP in the public sector. The private sector's share in value added (excluding oil) and investment did go up, but the public sector has remained dominant in activities outside agriculture. Between 1974-1980, Egypt was able to achieve rapid economic growth accompanied by significant social progress. Average GDP growth was 9% during this period. However the economy faced widening financial disequilibria and the current account and budget deficits averaged 10% and 23% of



on oil, with non oil exports stagnating. Finally the combination of rigid domestic price controls, tight import restrictions and inflexible and overvalued exchange rate created distortions in the economy. Yet these structural problems were not addressed because there were still large inflows of foreign exchange due to oil exports, workers' remittances and direct foreign investment.

#### **4. The fourth phase (1981-1990's)**

Reviewing the current period that started with the take over of Mubarak in 1981, one can note that he is adopting the same policy as Sadat i.e. mixed economy. Under Mubarak's rule, more emphasis is put on the private sector so that its share in total investment will reach 39% in 1987/1992 five year plan. When oil related foreign exchange revenues started to decline in 1982, the economy was not well prepared to face the consequences. During the next three years, the government managed to maintain a rather high growth rate i.e. 6% through expansionary economic policies but this resulted in increasing the B/P deficits, which could be only financed through increased foreign borrowing. As a result Egypt's total foreign debt doubled in 1982-1986 while its debt servicing capacity declined. By 1987 the government could not pursue such expansionary policies and through quantitative restrictions, imports were reduced by one third within two years. Economic growth fell sharply to 2.8% per annum and improved slightly in 1988. Still the public sector enjoyed the state's support and in 1988, 75% of the limited domestic credit has gone to the public sector to cover the larger than planned budget deficit.

The large public borrowing meant that scarce economic resources have been used to maintain domestic consumption rather than to stimulate investment and production. The large budget deficits stimulated domestic inflation so that the consumer price index rose by 25% in 1987 and 1988. These unsatisfactory economic developments were partially the result of a series of highly unfavourable external shocks in shape of reduced revenues from oil, from workers' remittances and from the Suez Canal. In addition a number of long standing government policies have also prevented the economy from realising its full potential. These include the weak performance of the SOEs that resulted in an overall deficit of 23% of GDP in 1986 which was brought down to an estimated 16.3% of GDP in 1988.

### **C. Various categories of SOEs in Egypt:**

Before analysing the performance of SOEs in Egypt, we will first quote the various types of SOEs existent in Egypt. There are five categories of SOEs in Egypt which comprise the following:

#### **1. Governorate owned enterprises (GOEs)**

These are about 2000 in number. They are owned and operated by the local governorates and their local councils. A large number of such businesses are but small craft shops and local bakeries. Others operate in agriculture, food security and local transportation. Most of such operations are funded either directly through the central government's budget or via loans or grants from international funding sources. All workers and employees of those enterprises are seconded from the local governments. This is a very important factor that would help



alleviate most labour related issues encountered in any privatisation programme. Because once these businesses go private, the redundant labour could return to the local government.

## **2. Joint Venture Enterprises (JVEs)**

These are about 245 companies where the equity capital is a mixture of public and private funds. The private sector contribution in those enterprises is in the form of shares sold to private individuals or banks or companies. It should be remarked that in some joint ventures the private sector has the majority stake in equity.

## **3. State Owned Enterprises (SOEs)**

These are enterprises fully owned by the government. They amount to about 400 enterprises that operate in almost every sector of the economy. However since the majority of those enterprises are not significant in terms of security implications, extent of capital investment and volume of employment, they are not considered to be strategic by the government.

## **4. State Authorities**

These are governmental authorities wholly owned by the state. Some of such authorities enjoy autonomy in their operations such as the Suez Canal Authority whose revenues go directly to the government budget. Others belong to the various ministries which incorporate most municipal services such as electricity, water, railways, airports and telecommunications.

## **5. State Owned Estates and Natural Resources**

These include all dormant lands, minerals, shores, waters

and fisheries.

#### **D. Analysis of the SOEs performance in Egypt:**

Since the 60's the SOEs have played a significant role in the Egyptian economy and even today SOEs continue to be the cornerstone of economic policy and planning despite recent efforts to encourage private investment. Many factors continue to give SOEs the vital role they have in shaping the Egyptian economy. They often monopolize key industries and control a large portion of public resources. Moreover they significantly contribute to the trade of major export and consumer goods and also are the main borrowers in domestic markets.

There are currently 370 public enterprises under the supervision of 18 ministries, with no particular agency responsible for overall coordination, planning and evaluation. In industry alone public enterprises represented 60% of the sector's value added, 82% of the capital stock, 54% of employment and 90% of exports in 1985. Because of its weight in the economic structure, the contribution of public industry to GDP growth is substantial i.e. it reached more than 25% in 1986 and at the same time the overall deficits of the non financial SOEs reached more than 8% of GDP in 1984.

In a country where such a high share of industrial capacity is publicly owned, it would appear difficult to achieve satisfactory overall economic growth without any improvement in the public sector performance. Consequently, much more attention has been focused recently on SOEs performance.

In analysing the efficiency of SOEs, extensive use has been made of the data contained in two World Bank Documents: "



Egypt: Review of the finances of the decentralized public sector 1987" and "Egypt: Country Economic Memorandum 1990". In the following section, the overall performance of SOEs is studied in relation to their impact on various key indicators eg. overall deficit, budget, rate of return on capital, debt to equity ratios etc.. This study which was conducted by the World Bank in 1987 explores the operations of 360 non financial public companies and 37 economic authorities over a ten year period 1973-1984. It should be pointed out that examining the performance of SOEs in Egypt would help us in determining whether they need to be privatised or not.

### **1. Overall Deficits**

A major indicator of financial performance is the overall deficits of SOEs. This variable summarizes the amount of resources that have to be transferred from the rest of the economy including the government to SOEs. The overall deficit is defined as the difference between total expenditure (excluding depreciation and profit transfers to the government) and total revenues (excluding government transfers). The overall deficit expressed as % of GDP has risen from 4% in 1974 to 8.4% in 1984.

A break down by public companies and economic authorities as shown in Table (3.1) indicates that public companies have contributed more to the deficits than the economic authorities. The main reason for this pattern is the large surpluses of the two key economic authorities i.e Petroleum and Suez Canal, which helped in reducing the deficits of the economic authorities. If we exclude both the Petroleum and Suez Canal

surpluses, the deterioration in the overall balance of the economic authorities becomes alarming as shown in Table (3.2).

## **2. Impact on the national budget**

One of the major consequences of large deficits in SOEs is the large fiscal deficit they create at the national level. As one can note from Table (3.3), there has been a parallel increase in the SOEs deficit and the national fiscal deficit as % of GDP. In particular the SOEs deficit as % of GDP reached 5.5% in 1984, whereas the national fiscal deficit reached an alarming 20.2% of GDP at the same year. Thus in 1984, SOEs deficit constituted about 30% of the national deficit. Hence any reduction of the SOEs fiscal burden can reduce the national fiscal deficit. The picture becomes more gloomy if we compared Egypt with twenty two developing countries. In Table (3.4) we will discover that SOEs in Egypt had the largest deficit in the period 1974/77, which was slightly improved in 1978/80 by being third after Portugal and Turkey. Table (3.5) compares the situation in 18 developing countries with respect to the net fiscal burden of public enterprises. Again Egypt ranked high in terms of the magnitude of the fiscal burden caused by deficits of SOEs i.e. it was third after India and Tanzania in the period 1974/77 and ranked highest in the period 1978/80. The large budgetary burden in Egypt indicates that SOEs had a destabilising impact on the economy i.e. instead of generating additional resources, they diverted limited state resources for their own use. Hence a reform of the fiscal situation would require a reform of the SOEs.



### **3. Rate of return on capital**

Large overall deficits and high budgetary burden are symptoms of the same weakness i.e. low rate of return on capital invested. Table (3.6) gives the net rates of return in public sector companies on the basis of the book value of capital as well as on the basis of revalued assets. The former is largely an accounting concept and is of limited use because it tends to overstate the rates of return. A more relevant concept is the rate of return on revalued assets that takes into account the impact of inflation on replacement value. As you can observe, both rates of return have followed a declining trend. In particular, the second rate showed a deterioration from 5% in 1973 to 1.71% in 1984.

### **4. Debt to Equity Ratio**

The mounting financial difficulties tended to weaken the SOEs financial capital structure, specifically, their debt to equity ratio. Between 1973-1984, the debt to equity ratio of SOEs increased dramatically as shown in Graph (3.1). Of course their main source of borrowing was the government. In most of the cases the SOEs did not service the debt owed to the government and virtually treated it as equity. The key elements underlying the increase in debt have been short term borrowing and payment arrears. Hence commercial bank credit in public companies grew by an annual average of 26% between 1973-1984. This was due to the growing deficits in a large number of SOEs and the fact that the government pursued a rather liberal policy of allowing enterprises to run overdrafts on the public commercial banks.

Another alarming factor is the large growth in payment arrears which increased at an annual average of 20% between 1973-1984. Further when the arrears are between public enterprises themselves, this leads to a painful chain link effect. For example the railway authority does not pay the engineering industries because the supply authority has not paid for rail services. This leads the engineering industries not to pay to the steel industry who in turn does not pay to the electricity authority and so on. This could in effect lead to a break down of normal transactions between SOEs and other economic agents.

#### **5. Impact on the B/P and public debt**

There is a direct link between SOEs deficit and the B/P deficit. A large resource gap in the SOEs creates excess demand pressures. To close the gap, the resources have to come either from the rest of the domestic sector or the external sector. Since under the present policy SOEs are not allowed to borrow from the private sector, their finance has to be obtained from the national budget or the banking sector.

Also SOEs cannot raise money from the capital market in Egypt because it is not well developed, a matter for detailed consideration in chapters (7) and (8).

Coming back to the SOEs deficits, we will recognize that they will cause increases in domestic bank credit, in national fiscal deficits and also in B/P deficits. Other things remaining constant, an increase in domestic credit due to SOEs operations, would expand the money supply and create inflationary pressures. Similarly an increase in SOEs borrowing from the external sector would raise the debt servicing



requirement and henceforth increase the pressure on the B/P. It should be mentioned that though Egypt had access to large inflows of foreign capital since 1974 and early 80's, the bulk of the foreign financing was channelled to the public sector either through the national budget or direct borrowing by the public sector itself. Unfortunately these large borrowings by SOEs in the 70's and 80's caused Egypt's public debt to grow substantially. From Table (3.7), it could be depicted that over one third of Egypt's total debt is owed by SOEs.

#### **6. International competitiveness**

As mentioned before the SOEs main source of finance is debt which has been increased continuously throughout the last twenty years. Large debt per se does not represent a problem, the crucial variable is rather SOEs debt service capacity. This will depend on the SOEs international competitiveness and their ability to generate enough earnings to be able to pay both the interest charges and the debt repayment itself. This could be studied by tracing the SOEs export capacity. In Table (3.8), it could be viewed that growth in exports was 16% between 1974-85, however much of this growth was due to the oil and Suez Canal. Since 1979, Oil and the Suez Canal dues has accounted for over 55% and 17% of the total goods and services of SOEs exports, whereas other public sector exports grew by less than 3% annually. On the other hand, over 90% of SOEs debt is due to enterprises other than Petroleum and Suez Canal. Therefore we reach a situation where SOEs foreign exchange needs surpass their earnings and this large gap in Table (3.9) has to be financed from the rest of the economy or abroad. Consequently,

this foreign exchange gap augments the B/P deficit, which once more emphasizes the fact that an improvement in the B/P deficit would require an improvement in the foreign exchange earning capacity of SOEs i.e. their exports.

#### **7. The impact of SOEs on money and credit**

There was a tremendous growth in Egypt's money supply between 1973-1985 i.e. 35% annually inasmuch as real income increased by 10% per year. Sequentially this has led to an increase in inflation to reach 22%. The main impetus to the surge in money supply was provided by domestic credit expansion. Therefore we find that domestic credit increased by 31% annually which roughly matched the growth rate in money supply. The large growth of SOEs credit affected public sector bank borrowing and imposed a burden on the national budget. That is why we find a close link between SOEs deficit and national fiscal deficit. Furthermore since Egypt has limited credit, so by allocating more credit to its SOEs, this deprives the private sector from enough credit i.e. crowding effect which in turn reduces private investment and production.

#### **8. Efficiency of public investment**

One of the important measures that should be considered when assessing SOEs is the economic efficiency of public investment which is measured by the domestic resource cost. A previous study by the World Bank on the basis of domestic resource cost criteria showed that activities in which Egypt had international comparative advantage were textiles, manufactured food and electrical machinery so that it would benefit from concentrating investments in these areas. On the



other side, Egypt had a relative disadvantage in the fields of basic chemicals, metals and transport equipment so that in undertaking these activities Egypt would have tied up resources that could have been better utilised elsewhere in the economy. The pattern of public investment in industry in the period 1974-84 showed that over 60% of the invested resources have been devoted to the promotion of chemicals, metals and engineering sectors where Egypt's international competitiveness is weak. In addition there are other problems of inefficiency of investments in SOEs e.g. the level of investment and priority given to gas development are highly inadequate, there is excessive investment in railways and too little in waterways, the refinery capacity does not match the pattern of demand, there is excessive water loss due to inadequate investment in maintenance and repair of water supply network.

## **9. Summary**

From the above discussion of the performance of non financial SOEs in Egypt, one can find out that SOEs in Egypt suffered from some major problems which included the following:

- Weak financial performance that results in increasing SOEs deficits.

- High debt ratios and weak debt service capacity.
- Deteriorating factor productivity.
- Low economic efficiency of investments.
- Large budgetary burden.
- Declining rate of return on revalued assets.
- Deficits in SOEs are highly correlated with B/P deficits.

## **E. Reasons behind the deteriorating performance of SOEs:**

Before making any suggestions concerning public sector reform, a diagnosis of the reasons behind SOEs substandard performance will be effected.

### **1. Macroeconomic policies**

It should be noted that the macroeconomic policies pursued by the Egyptian government in the late 70's and 80's had a negative effect on the performance of its SOEs. In particular, the exchange rate, interest rate, trade regime, pricing policy and impediments to the role of the private sector have all contributed to the substandard performance of SOEs.

#### **a. Overvalued exchange rate**

In Egypt, the exchange rate has generally tended to be overvalued. Before May 1987, there had been three exchange rates including the tolerated free market rate i.e. \$1 = 2 L.E., the official commercial bank rate i.e. \$1 = 1.36 L.E. and the official Central Bank rate i.e. \$1 = 0.70 L.E. Most foreign exchange transactions were conducted at the Central Bank rate, which included important exports such as oil, raw cotton, rice, Suez Canal dues and many imports such as basic food stuffs, agriculture inputs and public sector capital transactions. As one can clearly visualize the overvaluation of the exchange rate imposed a great disincentive on the exports of SOEs.

#### **b. Negative interest rates**

In Egypt the interest rate was always controlled by the government through the Central Bank to curb inflation. However this made Egyptian pound (L.E.) savings earn a negative



rate of return and consequently lending rates were lower than what they should be. Due to the negative rate of return on L.E. savings, foreign currency savings has increased from 44% of total deposits to 58% in 1990, according to the Central Bank of Egypt figures. This policy of negative interest rates was distorting since interest rates on loans did not represent the true opportunity cost of investment. The situation was even worse for SOEs since they were allowed to borrow from commercial public sector banks or the National Investment Bank at an even lower interest rate than the prevailing negative market interest rate. Of course this artificially low interest rate induced excessive capital intensity of production on behalf of SOEs and made them depend heavily on debt finance which in turn distorted their capital structures.

### **c. Controlled trade regimes**

In general trade policies in Egypt favoured production for the domestic market over exports. The tariff structure has remained as a high average tariff on consumer goods and low average rates for capital and intermediate goods not locally produced. Paradoxically the activities that have been discouraged were the ones with higher economic rates of return and those that have received stimulus had low or negative rates of return.

As one can observe, the combination of overvalued exchange rate, tariff structure and trade controls has resulted in a substantial bias against SOEs' exports as well as an acute distortion of production incentives to the SOEs.

#### **d. Rigid pricing policy**

Of all policies used by the government in Egypt, the pricing policy has been the most distortive for SOEs. The main objective has been to keep the prices of SOEs low so as to protect the standard of living of poor people. Therefore the government offered consumers a large number of commodities at unrealistically low prices and at the same time imposed a rigid system of price control on the goods and services produced by SOEs. Hence SOEs prices grew at a much slower rate than the Consumer Price Index. In addition price changes have been infrequent because of the fear of inflation and socio-political implications and even when implemented by the government, they were always much lower than the inflation rate.

As one can anticipate, the adopted pricing policy imposed a major constraint on the finances of SOEs. It also caused a severe distortion of incentives and resulted in lack of accountability in SOEs.

#### **e. Impediments to the role of the private sector**

The business environment in Egypt has created disincentives to the development and promotion of private industrial ventures. The World Bank Document (1989) presented six reasons behind the low participation of the private sector in the economic development of Egypt.

##### **1. Investment laws:**

Egypt has a complicated and cumbersome investment approval regulation involving several different agencies. Further there are always frequent revisions in the legal framework governing investment (both new laws and amendments



to old ones). The result is a body of inconsistent, occasionally contradictory laws involving multiple administrative and supervisory organisations. According to the Cabinet of Ministers Information Centre Manager, El Sherif (Saraya, 1991) there are about 85,000 laws and regulations used in Egypt which would not only impede the economic reform programme but also the whole society's welfare. He added that experts asserted that this vast number of contradicting laws could be reduced to only 4,000 laws. This will certainly create a more positive environment for investment and economic development.

## 2. High investment costs:

The lack of a functioning capital market and legitimate venture capital institutions has made it very difficult for private entrepreneurs to undertake large investments. Furthermore this made them rely extensively on bank loans instead of raising equity through the stock market.

## 3. Freedom of entry and exit:

In the 60's the government designated certain sectors as strategic thereby excluding the private sector from investment e.g. heavy industry and industries of monopolistic nature. Throughout the 80's the government has been relaxing these restrictions as is the case in textile and food industries. Still certain sectors may be closed to private investors due to under-utilized capacity in existing SOEs. Freedom of exit is restricted because SOEs cannot be declared bankrupt by law. In addition banks are reluctant to liquidate troubled private companies. Thus it becomes hard for new entrants who may be

more efficient to enter those activities.

#### 4. Access to credit:

Since 1987 the government has pursued a restrictive monetary policy to curb inflation so access to short term credit has become very exclusive. Adding to this factor the rise in interest rates, it is expected that both investment and output will be reduced in the short run.

#### 5. Regulations:

The government's ex-post investment supervision of companies is cumbersome, lengthy and its enforcement of various regulations is highly inconsistent with respect to important operations critical to the company's performance e.g. foreign exchange use and retention, import procedures and credit approvals. Thus the Annual Economic Review (1990) stated that the problems of the private sector in Egypt were mainly with two entities, the tax authorities and the customs. With the former there were the arbitrary and haphazard tax evaluations, high interest charged on tax arrears and disregard of books by inspectors. As for the latter, grievances centred on the absence of evaluating duties and the ambiguity of customs categories. This was stressed by Kholi and Sood (1987) who said that the efficiency and honesty with which policies such as taxation, customs and licensing are administered could be more critical to enterprises than the policies themselves.

#### 6. Failure of several private enterprises:

Several private industrial investments undertaken in the 80's have shown disappointing results due to heavy reliance on imported goods and equipment and long implementation delays.



They also suffered from the devaluation of the Egyptian pound which made the servicing of their foreign debt component a very complex matter. This led both investors and banks unwilling to pursue medium/long term investments particularly in industry.

## **2. Internal Policies of SOEs**

On the other hand, one cannot neglect the fact that there are some internal policies which pertain to SOEs and have added to their inefficiencies. First from diagram (3.1) which displays the management structure levels under the old public sector law 97/1983, one can note the excessive controls that the General Organisation had on SOEs. As remarked by Sherif (1990), the General Organisation and the General Assembly of an SOE took all the major decisions concerning its pricing, wages, production and investment. Further they had an influence on the following policies:

### **a. Financial management policies**

The **capital structure**, which is a primary determinant of the credit worthiness of a company is virtually irrelevant in case of SOEs because in most cases the government is the chief source of finance (either through the Ministry of Finance or public commercial banks). It is well established that a public enterprise that finances the bulk of its needs through retained earnings is likely to be more autonomous in financial matters and plan its operations better than an enterprise that is dependent on the government for finance. However for the majority of SOEs in Egypt, the main source of working capital has been the banking sector and as the real interest rate on bank credit for the economy was negative, this factor

contributed to the excessive growth of overall bank credit, to a relatively high capital intensity of production and as an incentive for SOEs to borrow heavily.

Another financial problem that is inflicted on SOEs is **the rigid rules for the allocation of SOEs surpluses**. Usually 80% of the surplus is transferred to the state, 10% for workers' welfare and the remaining 10% retained as statutory reserves. However enterprises are allowed to set aside some funds as provisions for depreciation and bad debts. The depreciation allowances are based on book value and therefore are deficient in relation to the replacement value of assets. If an enterprise wishes to retain a larger share of its surplus, it has to go through a lengthy and bureaucratic process of approvals. In practice to avoid the lengthy procedures, SOEs have succeeded in retaining a larger share of their earnings by understating their true earnings eg. they charged an expense item a fairly large sum of money that is shown in their budget as provisions.

Finally concerning **the investment selection procedures** that regulate the public enterprises, we find that they are too strict in some areas and too loosely defined in others eg. investment appraisal involves reviews by several agencies and are often delayed. As pointed out by Sherif (1990), the bulk of investment financing has been through the state so that SOEs cannot respond quickly to take advantage of certain developments in the market.

#### **b. Employment and wage policies**

In 1962, following the completion of the



nationalisation phase, the government launched a massive employment drive that caused most SOEs to be burdened with serious overstaffing. Although the policy was softer and much relaxed in the 70's so that SOEs are not required to hire unless there is a need for labour, they are not free to fire existing employees or transfer them among different enterprises. The rigidity in labour laws has weakened management control over labour quality and discipline. Furthermore wage policies are characterised by low basic wages with promotions and increments based on seniority. In practice, bonuses have been uniform and have become part of wages with no relationship to enterprise productivity and profitability. Sherif (1990) indicated that since the BOD of SOEs, as shown in diagram (3.1), consisted of employee representatives, it was almost impossible for management to change the wage and incentive levels. He added that even when SOEs were losing as was the case in commercial enterprises, employees got their bonuses.

### **c. Regulations concerning output mix**

The government also intervenes directly in determining the output level and its composition for its SOEs. Usually it sets output targets where affected enterprises are compelled to produce at least the quota defined. The problem with a quantity target is that it becomes an end in itself so that SOEs follow this objective without any regard to cost efficiency or quality. Of course those restrictions give wrong signals and cause resource misallocations for SOEs. Sherif (1990) gave an example of El Nasr Company for Packaging Bottles

that was compelled by the General Organisation to produce the quarter litre bottle, even though it had the lowest rate of return.

#### **d. Performance evaluation mechanism**

In the framework of the old public sector Law 97/1983, there is lack of a well defined performance evaluation mechanism. The evaluation process is not properly explained and the actual outcome of the reward process has shown a striking similarity in the reward levels across enterprises. It seems equity is the key element in the present incentive system. Also examples of SOEs managers losing jobs due to poor performance have been rarely encountered.

The basic problem seems to be the multiplicity of constraints induced by government policies, which has made it very hard to establish an objective mechanism for evaluating managers' performance in SOEs and in turn initiating a reward system that is based on achievement not favouritism, nepotism or mere equity as occurs now.

The same phenomenon was encountered in developing economies. Thus Heald (1985) stated that even when the various objectives were specified, it was still difficult to construct a satisfactory evaluation system. Further Choski (1979) and Shirley (1983) pointed out to repeated examples of technical and administrative shortcomings in the public sector of developing countries, in specific, the absence of monitoring of even the most elementary kind.

From the above, it is clear that the inferior performance of SOEs was mainly due to the macroeconomic policies employed



by the government as well as the internal policies inherent in SOEs. Both factors had a distortive effect on the efficiency of SOEs in Egypt.

#### **F. Proposed solutions for SOEs reform:**

Since one of the main causes behind the deteriorating performance of SOEs in Egypt has been the macroeconomic policies used by the government, hence a macroeconomic reform programme becomes of top priority for improving the capability of the SOEs. This explains why the Egyptian government has undertaken an ambitious economic reform programme in 1990, as advocated by the IMF, in order to abolish the existing distortions in its macroeconomic policies, as mentioned by Al Ahram Weekly on 10/4/1991.

##### **1. Macroeconomic reform**

###### **a. Adoption of a free foreign exchange market**

In response to the IMF demands, the Egyptian government established a Free Foreign Exchange Market i.e. FFEM on 28/2/91, which has put an end to a long state intervention in the exchange rate determination since the 50's. The expected effect of this reform is to reduce the import intensity and capital intensity of the public sector. Once SOEs are given the signal that their purchases of foreign exchange will not be subsidized, they will make greater effort to conserve foreign exchange by using it more selectively and efficiently. In addition since imported capital goods will no longer be subsidized by the overvalued exchange rate, SOEs will move towards relatively more labour intensive techniques of production. Finally Mohanna (Interview, January 1991) pointed

out that the impact of the FFEM will be favourable only on viable SOEs whereas the loss making SOEs will not be able to survive under the market system and have to be liquidated.

#### **b. Liberalised interest rates**

In order to end the phenomenon of negative interest rates, the Egyptian government liberalized interest rates on January 1991. One can envisage that this reform will be harsh on SOEs in the short run, since they will no longer be subsidized by the government but have to borrow on their own merit at real interest rates. In addition SOEs will become more selective in their future borrowing and they will start depending on other sources of finance such as raising new capital through the stock market. In a way, liberalizing interest rates could be one of the factors that can help accelerate the privatisation process.

#### **c. Reform of the trade regimes**

Recently the Egyptian government abolished the general import licensing system and replaced it with a more limited list of banned imports, reduced import tariffs and allowed exporters to retain their foreign exchange earnings. Nevertheless there are still some improvements that need to be incorporated later. The expected effect of the trade reform on SOEs can be negative in the short run since they will be subjected to severe competition from foreign producers, but in the long run this will make them more efficient and competent.

#### **d. Reform of the pricing policy**

In accordance with the IMF demands, the Egyptian government started correcting its pricing policy. In the new



pricing reform, SOEs that work in competitive environment eg. manufactured foods and beverages, textiles, hotels etc.. are allowed to set their prices based on the forces of demand and supply, the same as the private sector. The prices of other products of SOEs that either lack competition or could not be traded internationally, will be gradually increased by the government in order to mitigate the associated cost on the poor. However the long run objective of the government will be to free all prices with the exception of those that are identified by their nontradability or monopoly market structure.

**e. Enhancing the role of the private sector**

Kholi and Sood (1987) asserted that the most critical prerequisite for developing dynamic and efficient enterprises is the creation of a business environment that encourages efficiency and competition.

Hence President Mubarak in his speeches on May 1990 and 1991, stressed that the overall atmosphere in Egypt will be supportive to the private sector by abolishing any obstacles that impede its investment and development, including the phasing out of public sector distribution monopolies. Further the government has recently announced that about 50% of the total investment of the next five year plan (1992-1997) will be allocated to the private sector. Finally the Addendum to the memorandum on the structural reform of the Egyptian economy (1990) disclosed that the procedures for investment licensing for the private sector are being reviewed with the aim of simplifying them.

## **2. Internal reforms**

In addition to the above mentioned macroeconomic reforms, the World Bank Document (1987) proposed various reforms for the internal policies of SOEs.

### **a. Financial reform**

Since SOEs suffer from a high debt ratio and an excessive build up of arrears, the basic reform measure would be to convert a large portion of the government's loans into equity. In other words, the government should write off the debt which will result in an acceptable debt to equity ratio for its SOEs. Though in this case the government absorbs all the liabilities of its SOEs, this step is necessary to provide the SOEs with positive net worth, which is essential for their future functioning. In addition the government might inject new capital where required to resolve the arrears problems. This should be a once and for all capital restructuring and SOEs should be held fully accountable for future financial obligations.

A second policy action is to stop state budget transfers from the SOEs except for clearly defined objectives. This requires establishing well defined procedures for direct subsidisation of SOEs operations. A general objective would be to reduce subsidies for enterprises gradually to a minimum level. Only if it is socially efficient to subsidize the use of some facilities eg. water and sewerage, will the government price them below the financial cost.

A third measure is to institute an appropriate surplus substitution policy. SOEs should be allowed to determine the



appropriate distribution of surplus between reinvestment and dividends. This gives more flexibility to SOEs in planning their operations over a longer period and additional incentives to management. It removes an existing inconsistency in the system which commands SOEs to surrender their surplus on one hand while they struggle to pay interest and debt repayment on borrowed funds to the Treasury.

A fourth policy measure is that the government's role in planning SOEs investments should be limited to providing a general framework for the selection of projects based on economic efficiency.

In the end SOEs should be allowed to raise funds from the private sector and commercial banks, without government guarantee, which will relieve pressure on the national budget. This will necessitate the development of the capital market in Egypt to provide an extra instrument for SOEs whereby they can raise funds. Since currently the SOEs depend on borrowing from the National Investment Bank i.e. NIB, a state owned bank, the interest rates charged by the NIB should reflect the true opportunity cost. This is because low interest rates encourage excessive capital intensive products. On the other hand if the government wants to subsidize a certain industry, it should do so directly rather than through low interest rates.

#### **b. Employment and wage policies reform**

In this aspect, there is a need to better define the government/enterprise relationship and increase the autonomy of SOEs. This could be done by removing the restrictions on employment and wage setting. While it will be politically

difficult to fire excess workers, stronger efforts should be made to eliminate excess labour through restraint on new employment, multiple shift operations and early retirement schemes, which were incorporated in the new public sector law. SOEs should set wage differentials and incentive payments based on skills and performance. Bonuses for workers should be based on the quality of production rather than on meeting targets. Eventually workers should get a clear signal from management that bonuses are not automatically guaranteed but fairly depend on their efficient performance.

#### **c. Reform of the public sector law**

It should be mentioned that the Egyptian government has approved a new public sector law on May 1992 which cancelled a lot of the impediments facing the public sector. The management structure levels under the new law are given in diagram (3.2). The new law is quite liberal as it has allowed management more autonomy and freedom from ministerial interference, related wages and incentives to performance rather than to seniority, removed all regulations concerning the level, composition and marketing of the goods and services produced by SOEs, allowed SOEs to raise money through selling their shares in the stock market and made employee share ownership plans possible.

#### **G. Privatisation: is it a possible option for SOEs in Egypt?**

Given the size, diversity, complexity and problems that face SOEs and handicap their performance, one cannot escape asking the question whether Egypt will be better off by reducing the number of its SOEs i.e. could privatisation be the solution to



the SOEs troubles?

First it should be pointed out that in Egypt the transfer of all public sector companies to the private sector is neither politically feasible nor commercially desirable.

**1. Areas where the public sector will continue to operate**

El Naggar (1988) asserted that the public sector will proceed to play an important role in the process of development in the coming period. In addition to the conventional functions of the government in health, education, defence etc., the public sector will continue in the following areas:

1. Control over natural resources eg. Suez Canal and Petroleum where the public enterprises have been fairly successful and earning revenues for the state.

2. Natural monopolies eg. railways, ports, telephone, water, sewerage etc.. where privatisation in such cases would substitute a private monopoly for a public one, unless a regulatory body is established that ensures that the newly privatised company does not exploit its position. This requires a lot of legal changes that cannot be implemented in the short run.

3. Substantial divergence between private and social benefits whereby the benefits of the private entrepreneur from a certain economic activity are less than the benefits that accrue to the society so that the profit motive will not ensure an optimum level of investment eg. training, research and development.

4. High capital requirements or high technology projects which go beyond the capability of domestic private enterprises such as defense industries, Iron and Steel industries etc..

This was emphasized by Doheis (Interview, November 1991) and Handoussa (Interview, January 1991) who both asserted that capital intensive, strategic and overmanned industries will be excluded from privatisation plans.

Therefore enterprises in those four categories will constitute the core of the public sector where government intervention is justified.

## **2. Industries / sectors that can be privatised**

The World Bank Document (1987) agreed that the scope for denationalization or divestiture in Egypt is particularly large in the industrial, service and transport sectors eg. hotels, trade, textiles, food processing, retailers, chemicals, engineering, advertising, department stores, contracting, bookshops etc.. This is because many of the public enterprises in those sectors are in the small and medium scale category and already operate in a competitive environment. Further such activities cannot be defined as strategic and are in most cases run at considerable financial losses.

The report added that there are other forms of privatisation other than divestiture which could be considered more favourably by the government. Hence subcontracting arrangements between the public and private enterprises are feasible e.g. Railways, which can subcontract its maintenance service to the private sector. Also there is management subcontracting which is already applied in the case of five star hotels in Egypt. Further there is the option of leasing. Handoussa (Interview, January 1991) disclosed that some public sector companies rent their production lines to the private sector, either local or



foreign, as in the case of the textile and soap industries. Nevertheless the World Bank Document (1986) stated that privatisation in Egypt should first start by identifying the suitable candidates, then definition of the restructuring needs should be undertaken whether an SOE was to be privatised or not. Next the method of sale either to private companies or Employee Share Ownership Plans or management or the public in general should be decided and the legal agreements prepared. The government should have a specific agency responsible for the implementation plans. In the end which type of privatisation will be chosen should be based on a case by case assessment of the economic and political risks and benefits that are involved.

### **3. Objectives of the privatisation programme in Egypt**

In summary the objectives of the privatisation programme in Egypt at the macro level as defined by the government are:

1. Improving the overall productivity of the country.
2. Improving the country's economic performance through improving the balance of trade, reducing the budget deficit and payment of part of the outstanding government debt.
3. Encouraging better use of the available local resources.
4. Increasing the local value added.
5. Broadening the distribution of wealth.
6. Abolishing subsidies and controlled prices.
7. Strengthening the capital market.
8. Alleviating the government's burden of having to sustain ill performing SOEs.
9. Mending current technological gap.

#### **4. Privatisation in Egypt as part and parcel of an overall reform package**

Privatisation could be enhanced if it is accompanied by the needed adjustment policies aiming at eliminating all price, cost, trade distortions and macroeconomic imbalances. In general those measures comprise the main factors of any adjustment programme proposed by the IMF to developing countries to solve their B/P disequilibria and reduce their public sector deficit. Thus roughly the same type of reform package employed by the Egyptian government was implemented by other countries such as Turkey, Ghana, Colombia, Malaysia, Philippines and Nigeria as mentioned by Koptis (1987), Chand and Til (1988), Schloss and Thomas (1986), Somogyi (1991), Blejer and Guerrero (1988) and Tallroth (1987) respectively.

Summarizing the Egyptian perspective, Helmy (1991) emphasized that outdated government agencies should be cancelled while government employees should be trained on the techniques of market economy. He added that a well developed capital market that reflects accurate information is another necessity for mass privatisation issues. Moreover a highly technical and specialized authority should be responsible for privatisation rather than leaving it to every ministry. Finally privatisation should start with simple, easy cases and then as the government gains more experience, more complex cases could be handled.



**Notes and References:**

- **Interview with Doheis, A.** Chairman of the Tourism Public Sector Authority and Misr Hotel Company, November 1991.
- **Interview with Handoussa, H.** Professor of Economics at the American University in Cairo and Advisor to the Minister of Industry, January 1991.
- **Interview with Mohanna, O.** Head of Corporate Finance at Misr Iran Development Bank and Member of the Privatisation Steering Committee in Egypt, January 1991.

## Chapter 4 What should Egypt privatise?

### A. Introduction:

The purpose of this chapter is to identify a given sample of SOEs that could be possible candidates for early privatisation by the Egyptian government and to which the valuation exercise can be devoted in the subsequent chapter. Before deciding on first class hotels as one of the suitable candidates for privatisation, a synopsis will be given of other countries' experiences in the choice of suitable candidates for privatisation. Then a short summary will be supplied concerning the British team of experts' advice to the Egyptian government concerning the SOEs that can be easily privatised. Next the chapter will disclose the privatisation plan by the Egyptian government for its various SOEs. From the group of SOEs appointed by the Egyptian government for privatisation, there are firm indications that the tourism sector will be the first to be privatised. Consequently the chapter will give a detailed analysis of the overall performance of the tourism sector in Egypt. Afterwards the chapter will examine the unique characteristics inherent in first class hotels in Egypt that make them more profitable than their worldwide competitors. Finally the chapter ends by illustrating the reasons behind choosing five star hotels as the first SOEs to be privatised in Egypt.



## B. Other countries experiences in the choice of suitable candidates for privatisation:

Before discussing the reasons behind choosing the tourism sector as one of the earliest sectors to be privatised in Egypt, a short synopsis will be given below of how other countries has chosen candidates for privatisation from their public sector. First it should be pointed out that there is no definite rules concerning the SOEs that should be first privatised. This was confirmed by Cavazzuti (1990) who said that with regard to the choice of which enterprises to be put up for privatisation, the literature does not give any clear guidelines about which areas could be best managed by private companies. He added that theory does not go much beyond indicating that in the presence of competitive markets, preference should be given to private enterprises and that, on the other hand, where we have natural monopolists the choice should fall to the state ownership.

Nankani (1988) mentioned that in **Canada** the selection of targetted corporations for privatisation involved the application of several criteria i.e. SOEs role in support of national and regional policy objectives, their potential for commercial viability, their readiness for privatisation, their compatability with other policies and their effect on interested parties. Concerning **Chile**, Nankani (1988) said that the choice of SOEs to be privatised depended on a number of considerations i.e. whether the enterprise was considered strategic to the country, whether it was perceived by the general public as providing a public good, legal constraints prior to its privatisation, its relative importance to the

economy and its past financial performance. In general the less the above issues applied, the greater the ease and speed with which divestiture of SOEs in Chile could be accomplished.

Further Nankani (1988) indicated that both **Italy** and **Spain** have decided to sell SOEs that were either profitable so they did not fit well with their state portfolios or money losing so they were a drain on their resources.

On the other hand, Nankani (1988) remarked that management contracts and leases of industrial facilities were the main divestiture instruments used by **Sri Lanka** and **Togo** respectively since both were the least problematic forms of privatisation. Moreover Wilson (1991) stated that the first five SOEs that were privatised in **Poland** were profitable, non strategic enterprises. In addition Denton (1992) imparted that in **Hungary**, significant industrial sectors including cigarettes, newspapers, oil, sugar, confectionary, cement and glass were sold to westren multinational enterprises. The same was effected in **New Zealand** as mentioned by Pollock (1990). Finally Leeds (1988) disclosed that Port Kelang was a logical candidate for **Malaysia's** initial privatisation because it enjoyed widespread recognition, had a record of profitability and was not in a politically sensitive sector.

From the above, one can note that countries, whether developed or developing, in their initial privatisations, chose two types of SOEs to be privatised. The first type mainly non viable, losing SOEs were liquidated. On the other hand profitable, non strategic and competitive SOEs were privatised. The latter group were selected first because they could be easily and



quickly privatised since they will require minimal financial, technical and legal restructuring, will encounter less public criticism and will be more politically acceptable.

**C. British experts' advice to the Egyptian government concerning the enterprises to be privatised:**

In January 1991 a group of British experts were invited by the Egyptian government to conduct a conference on privatisation at the Cairo Marriott Hotel. [1].

The conference was attended by ministers, the Governor of the Central Bank of Egypt, economists, prominent businessmen and public sector top officials.

During the discussions, a recurrent question that was asked by most participants was: what type of companies should be privatised by the Egyptian government? In particular, the attendants were sceptical about the ability of the government to sell the public sector enterprises given their complicated problems such as losses, high leverage ratios, overstaffing. In parallel there was a doubt about the availability of potential buyers who are both willing and have the required liquidity to buy the shares of the privatised companies.

All these controversial issues were tackled by the British experts and a short synopsis is given hereafter of their view concerning the choice of suitable candidates for privatisation.

1. Commercial viability, risk and strategic considerations are three basic criteria that help in deciding whether a company could be easily privatised or not. In other words commercially viable, non strategic companies with a history of profitability and with less risk attached to their earnings capacity are good candidates for privatisation.

2. It would be best for the Egyptian government to privatise easy things first and avoid monopolies. Later when privatisation is proved to be successful, businesses will come forward themselves and ask to be privatised.

3. It is preferable to start with small profitable SOEs that are already in competition with the private sector. However as privatisation gains momentum and as the government learns more about it, difficult and loss making SOEs could be privatised.

4. It is better to start with simple cases in terms of legislative and administrative matters to avoid any unnecessary complications at the beginning of the privatisation programme.

5. Concerning loss making SOEs, the government could turn them around through writing off debt, laying off of excess labour, changing management, injecting new capital and technology: undertaking a complete rehabilitation scheme to make the company profitable. Buxton (1991) remarked that only when a SOE is profitable can it be sold as a going concern to the public as was the case with British Steel in the U.K.

6. Concerning the overstaffing in SOEs which represents one of the major constraints to their privatisation, attractive retirement packages would help reduce the acuteness of this problem. In addition the redundant employees could be encouraged to start their own small businesses with government granting them loans, which happened to the workers in the town of Corbay in the U.K. as remarked by Willets (1991). Finally the employees that will remain with the privatised company and are sceptical about privatisation, should be familiarized with the benefits in working in a privatised company to reduce their



reluctance. Finally making use of employee share ownership plans can enhance the image of privatisation among the disinclined employees.

#### **D. Privatisation plan concerning SOEs in Egypt:**

It should be remarked that this section draws upon the privatisation plan of the Egyptian government that was written in Al Ahram newspaper on 31/1/1992 and 3/4/1992.

##### **1. Governorate owned enterprises (GOEs)**

In 1990/91 the Egyptian government decided to privatise all its GOEs and it started immediately to sell these projects to the private sector. However there are no specific published figures about the total number of projects sold to the private sector nor the proceeds from their sale.

##### **2. State authorities and State owned estates**

In its privatisation plan, the Egyptian government has excluded two categories which are State Authorities and State Owned Estates and Natural Resources. Hence one can determine that both types of SOEs will be kept under the ownership of the government for the time being.

##### **3. Joint venture enterprises (JVEs)**

Out of the existing 245 JVEs, the Prime Minister nominated 138 enterprises to be privatised. He announced that those companies will be sold through the stock market in varying percentages i.e. in certain cases the government will sell 20-30% of its ownership, while in other cases it will sell 80-90% of its ownership; whereby the company becomes private and is out of the public sector. The decision of the percent of ownership that will be offered to the private sector will

be decided later. Below is the list of JVEs in which the state has various ownership stakes.

Number of JVEs	Sector
45	Industry
35	Agriculture
24	Tourism
34	Housing

It should be pointed out that the next stage to be taken by the government is to decide which JVEs out of this list will be first privatised. It has been reported that the decision to privatise a JVE will vary from one case to another and will depend on each enterprise's specific circumstances. In summary, an in depth analysis of the overall conditions of a given JVE will be concluded and then its management will decide which method of privatisation is best for it i.e. leasing or liquidating or a public offer or a private deal.

#### **4. State owned enterprises**

As for the SOEs, the Prime Minister remarked that the government is now in the process of preparing a list of thirty three companies that could be sold to Egyptian, Arab and foreign investors through the stock exchange. However he pointed out that the public sector will retain at least 51% of the capital of those enterprises at this phase. Thus one can perceive that the government's policy is to change SOEs into joint venture enterprises i.e. JVEs through the use of private placement or partial privatisation as a step forward towards their complete privatisation later.

#### **5. Certain guidelines governing the privatisation of SOEs**

a. It should be pointed out that the government has recently changed the public sector law. Furthermore in March



1992, the Prime Minister has assigned new management for the holding companies. Each holding company will supervise the performance of a group of SOEs of a given sector. The management of the holding company will make the necessary decisions concerning the SOEs i.e. required restructuring, sale of non earning assets, debt to equity swaps, employment training or laying off. This means that ministers will no longer interfere in the affairs of the SOEs.

b. Among the appointed managers of the holding companies, there were two different views. The first group, mainly private businessmen and university professors, were in favour of directly selling the SOEs to the private sector since their restructuring will require considerable funds which will increase the budget deficit which has already reached L.E. 14 billion. They believed that if the government sold the SOEs to the private sector, several gains could be achieved i.e. reduction of the budget deficit which will allow the government to have new investments which will create more jobs. On the other hand the other opinion advocated by the public sector management, stated that the private sector has done very well in certain fields that yield a quick rate of return. However they asserted that private businessmen are still reluctant to invest in long term and risky capital investments. Hence it is better to leave those projects within government ownership. In response to these two controversial views, the Prime Minister has asserted that certain strategic industries that involve substantial capital investments and at the same time are overmanned such as the Iron and Steel Company and the Aluminum

Complex will not be privatised now.

c. The government has no nationalistic fears in terms of selling shares of privatised companies to international investors whether Arabs or foreigners. On the contrary, Investment Law 230/89 allows non Egyptians to buy shares in stock companies even up to 100% as long as the sale would not have an adverse effect on the national economy.

d. Liquidation of SOEs is another option that the government is willing to take if any public sector company is beyond restructuring and represents a drain on the national budget.

e. The Minister of Planning reflected that the government should be very cautious in its privatisation plan due to several reasons. First the capital investment in the SOEs amounted to L.E. 31 billion whereas their debts reached L.E. 46 billion. Thus before selling SOEs, the government must decide on the settlement of their high leverage with the concerned banks, since the write off of debts might result in the banks being bankrupt. Second there is still doubt about the capacity of the local market to buy all those assets. Furthermore the government cannot sell all companies at the same time because if there is more supply of shares than demand, this will result in a drop in their economic value which will in turn harm the image of privatisation in the eyes of the public. Finally the overstaffing in some SOEs should be handled prudently by the government in order to lessen as much as possible the social costs associated with the lay offs of labour.



f. In the end the Prime Minister asserted that privatisation in Egypt will be executed on a piecemeal basis to avoid any reckless mistakes that would jeopardize the whole programme.

Finally it should be indicated that the World Bank Document (1987) confirmed that the scope for divestiture in Egypt is practically large in the industrial, service and transport sectors such as tourism, trade, textiles, food processing, retailers, chemicals, engineering etc.. This is because SOEs in those sectors are in the small and medium scale category and already operate in a competitive environment.

Hence one can infer that the Egyptian government will start with the easy, profitable, commercial SOEs that are already competing with the private sector. Then as privatisation becomes more acceptable and its benefits are more envisaged, the government could then privatise the more complex SOEs.

#### **E. Tourism Sector in Egypt:**

Now we will examine in detail the tourism sector in Egypt in order to visualize why was it chosen as a prominent candidate for early privatisation. In addition since five star hotels lie within the tourism sector, we cannot analyze their performance and privatise them without first referring to the main factors that influence the tourism industry, since this will definitely have an impact on the profitability of the five star hotels.

##### **1. Introduction**

Egypt has always held an irresistible fascination for tourists and it is not difficult to understand why. Pyramids,

the Nile, the desert, palms, the Sphinx, temples, tombs, exceptional archaeological treasures, almost continuously sunny climate, beautiful beaches and arguably the finest coral reefs in the world, are enough to make any traveller dream of at least one visit to Egypt in a life time.

## **2. Tourism Revenues**

Because Egypt is endowed with the above mentioned potentialities, the tourism industry has become one of its most important sources of national income. Table (4.1) displays the revenues side of Egypt's B/P over the period 1985/6-1989/90. It is clear that the tourism sector has been one of the fastest growing sectors during the past five years. It has increased sharply by 97.3% in 86/87, then it had an enormous increase of 129.7% in 87/88 and finally the rate of increase was the same for both 88/89 and 89/90 i.e. 19.9%.

This led to a phenomenal increase in tourism earnings over the period 1985/86-1989/90 which reached 550.9%. Consequently tourism attained an average annual compound rate of 66.7% over the same period. This was the highest rate if compared to the other receipts and ranked second if transfers were included, since official transfers has achieved the highest rate i.e. 102.8%.

Finally in the last section in Table (4.1), it was clear that the weight of tourism revenues to total revenues has been ascending over this period.

It should be pointed out that the revenues side of the B/P were based on the Central Bank of Egypt fiscal year i.e. (1/7/19X1-30/6/19X2) which of course differed from end of year results



(1/1/19X1-31/12/19X2) . The reason behind using the Central Bank of Egypt figures was that they allowed us to have a comparison between the various sectors of the Egyptian economy.

To avoid the confusion that might be caused due to using fiscal year results, Table (4.2) presents end of year tourism revenues. From those figures, it was further emphasized that the overall tourism revenues has increased at an astronomical rate over the period 1985-90 i.e. 714% that culminated in an average annual compound rate of 77.9%.

### **3. Analysis of the demand for tourism**

#### **a. Nature of demand**

Historically the majority of tourists visiting Egypt were mostly attracted by its cultural and archaeological sites rather than for holiday or recreational visits. However the recent attention given to the development of the Red Sea and Sinai areas as well as the expansion of resorts such as Hurghada and Sharm El Sheik; have encouraged international tour operators to produce multi destination packages within Egypt which combine the traditional cultural attractions of Cairo, Luxor, Aswan with the attractive beach resorts of the Red Sea area.

It should be remarked that the majority of reputable hotels in Egypt depend on business contracts that are heavily tailored to the G.I.T i.e. group individual traveller such as incentive groups who enjoy the highest level of discounting.

On the other hand, F.I.T i.e. free or frequent individual traveller include those who prefer to travel independently such as businessmen, crews etc.. and are less price sensitive than

G.I.T.'s but they still can get prices less than the rack or published rate by the Ministry of Tourism.

#### **b. Determinant variables of demand**

Table (4.3) exhibits the number of tourists visiting Egypt throughout the period 1980-90 per month, whereas Table (4.4) displays the number of tourist nights which is the product of the number of tourists times the nights spend by them in Egypt. It can be noted that the number of tourists and tourist nights have both experienced a slow growth during the period 1980-85, then in 1986 there was a distinct drop of 13.6% and 12.9% due to the incident of the Achille Lauro high jacking that occurred early 1986. Then there was a significant increase for both variables by 36.9% and 102.1% in 1987 which continued for 1988 and 1989 but at a lower rate. Finally in 1990 there was a large drop in the number of tourists and tourist nights by 3.9% and -3.1% due to the Gulf War.

The last item that will be analyzed in relation to demand for tourism will be the average length of stay or the number of nights spent by tourists. From Table (4.5) it can be realized that the average length of stay has followed a similar trend as the number of tourists and tourist nights. It can be observed that the number of nights has increased at an average annual compound rate of 2.9% which is rather low. On average the number of nights spend by tourists in Egypt was seven days, though in the later period 1987-89 there has been a conspicuous increase which slowed down in 1990 due to the Gulf War.

From the above it could be clearly illustrated that tourism in Egypt is highly sensitive to political conditions and



stability. Nevertheless the unstable environment in the Middle East, of which Egypt is part, did not have an adverse effect on tourism. Despite the unfavourable incidents in the last decade, the average annual compound rates for tourists and tourist nights for the period (1981-90) were 8.4% and 12.7% in 1981-90 as exhibited in Tables (4.3) and (4.4).

A variety of factors has helped to foster tourism levels in Egypt which include the following:

- Unification of the multiple exchange rates of the Egyptian pound to the free market rate and lastly in February 1991 the Egyptian pound was floated vis a vis against the dollar to create for the first time a true free foreign exchange market with no government intervention.
- Recent positive developments in the relationship between Egypt and its neighbouring Arab countries especially after the Gulf War.
- Egypt is considered a safe country with a stable political regime when compared with other countries in the Middle East.
- A consistent development plan geared towards a productive open door policy which was consummated by the recent economic reform programme undertaken by the government in 1990, which included privatisation as one of its key instruments.
- The tourism sector experienced minimum intervention from the government, in particular five star hotels owned by the government are managed by international management chains.

### **c. Seasonality of demand**

From Tables (4.2) and (4.3) we could realize that there was seasonality in demand as represented in the number

of tourists and tourist nights; where months July, August and September contained the highest number of tourists and tourist nights i.e. peak season.

However one should be aware of the fact that this seasonality will vary greatly depending on the places visited in Egypt. Therefore places like Luxor and Aswan as well as the Red Sea area will have their high season from October till April, while May through September represent their off season. The opposite is true for other places like Alexandria and El Arish which are summer resorts. Also the extent of variation in demand throughout the year has been partly hidden by the high level of frustrate demand during the peak season plus the availability of very attractive rates during the off season. These two factors have helped to curb the wide fluctuations in demand that could have been otherwise faced.

#### **d. Distribution of tourists by nationality**

Table (4.6) presents the number of tourists, tourist nights and the average length of stay for the period 1986-1990 according to the nationality of tourists. From this table we could infer the following:

- On average Arab and O.E.C.D tourists comprised the bulk of tourists visiting Egypt. The overall increase in the number of tourists for the period 1986-90 was 105.8% for Arab tourists and 96.1% for O.E.C.D. tourists, while the increase in tourist nights was 157.9% for Arab tourists and 140.9% for O.E.C.D. tourists.
- Though the average number of Arabs was lower than the O.E.C.D. tourists for the period 1986-90, the tourist nights



spent by Arab visitors was slightly higher than those spent by O.E.C.D. tourists.

- On average the length of stay for Arab visitors was about ten days while O.E.C.D. visitors stayed seven days only.

- It should be remarked that Arabs tend to visit Egypt mainly during the summer season because of its mild weather and the various entertainment facilities as well as the non existence of language or culture barriers. On the other hand Westerns preferred to visit Egypt during winter because of the Christmas and Easter holidays and to enjoy the exceptionally warm weather in Egypt at that time.

- Finally Arab tourists preferred to stay in Cairo while non arabs travelled all around the country.

#### **e. Expected future demand**

In order to estimate the expected demand for tourism for the coming ten years i.e. 1991-2000, the average annual compound rates calculated for the period 1981-90 in Tables (4.2) and (4.3) were used.

Hence a growth rate factor of 8.4% will be applied to the number of tourists 1990 figures, whereas a growth rate of 12.7% will be employed for the tourist nights 1990 figures. However it should be noted that the growth rates used were conservative because they occurred during a period where certain unusual circumstances prevailed which undoubtedly have lowered them. Therefore under normal conditions, one should expect a higher growth rate for both tourist and tourist nights.

From Table (4.7) it can be estimated that the number of tourists visiting Egypt by year 2000 is expected to be 5.8

million, staying about 65.9 million nights with an average length of stay amounting to 11.3 nights.

Now in order to predict the earnings that could be incurred from the tourism sector through the period 1991-2000, first the average spending per night will be calculated by dividing the tourism revenues by the tourist nights for the period 1985-1990 as shown in Table (4.8). Then a growth rate should be applied to the average spending amount in 1990 to be able to estimate 1991-2000 figures. From Table (4.8) we find out that the average spending per night was L.E. 138.4 or \$51 (1\$ = 2.71 L.E. in 1990) and that the average annual growth rate for 1985-1990 was 28.1%. However one should be careful in forecasting the average spending based on a five year data basis. To be very cautious in the derivation of the most likely growth rate, a weighted average of the average annual growth rate i.e. 28.1% and the expected annual growth in the tourism sector i.e. 15%, as confirmed by tourism professionals, was calculated. In the weighting of these two variables, the annual growth rate in tourism was given more weight i.e. 60% while the weight of the average annual compound rate was 40%. This produced an annual growth rate for average spending of 20.24%.

Hence in Table (4.9) a growth rate of 20% was used to calculate the expected average spending per night.

From Table (4.9) it can be perceived that by year 2000 tourists will spend about L.E. 856.9/night i.e. \$259.7 (Using March 1992 exchange rate i.e. \$1 = 3.3 L.E.). Consequently the expected tourism revenues by year 2000 will be about L.E. 56.5 billion i.e. \$17.1 billion.



#### **4. Analysis of the supply side of tourism**

##### **a. Hotel capacity grouped by region**

Tackling the other constituent of tourism i.e. supply, one can note that Table (4.10) displays the number of hotels in each region for the period 1985-1989.

From Table (4.10), it is observed that the largest increase in the number of hotels over this period was achieved by the Others region i.e. 72.4% followed by Luxor region i.e. 63.2%, while the Cairo region came last on the list i.e. 12.6%. This was confirmed in the average annual compound rate which was 15.1% for the Others region and 13.4% for the Luxor region, and 3% for the Cairo region. The last section of the table showed that despite the annual increase in the number of hotels for the Others and Luxor region, the Cairo region included more hotels than all Other regions for the period 1985-89, and only in 1990 that it ranked second to the Others region.

From this table, it could be indicated that though there were originally more hotels in Cairo than in any other city, there is recently a new trend of constructing hotels in favoured tourist areas such as Luxor and Others region i.e. the Red Sea and Sinai areas. This is due to the fact that the cost of erecting hotels in the Others region is much lower than Cairo and Alexandria plus the incentives that the government offers to investors in the form of tax holidays in order to develop these areas.

##### **b. Hotels grouped by category**

Table (4.11) shows the number of hotels grouped by category. From Table (4.11), it can be depicted that the Deluxe

hotels have assumed the largest growth over the period i.e. 54.5% followed by the Unclassified hotels i.e 52.6% and then the First hotels i.e. 43.4%.

As expected the overall increase over the period was reflected in an average annual growth rate of 14.2% for Unclassified hotels, 11.6% for Deluxe hotels and 9.6% for First hotels. Finally the last section of the table showed that Second hotels constituted the highest number of hotels i.e. 46.7%, then came First hotels i.e 37.7%, Deluxe hotels ranked third i.e. 8.4% and at last came Unclassified hotels i.e. 7.2%.

From the above it could be inferred that the number of Deluxe hotels available in Egypt ranked penultimate which is understood because constructing Deluxe hotels necessitates very high investment and operating costs. Nevertheless their overall % change was quite remarkable and ranked second if compared to the other categories. In addition the sharp increase in the overall % change in the number of Unclassified hotels should not be misleading because their number was very low in the beginning of the period and so any small increase in their number would result in a magnified overall % change. In other words, the weight of Unclassified hotels to the total hotel categories came last in 1989 which meant that despite having an overall high growth over the period, their number is still lowest if compared to the other categories.

Finally it can be detected that the majority or bulk of investment in hotels was highest in First hotels (3 or 2 star hotels) followed by Second hotels (4 or 3 star hotels) which is expected since the cost involved in their investment and



operation is much lower than the Deluxe hotels. Moreover hotels built in resort areas as well as residential areas in Cairo, far from the city centre, need not be five star, given that they are comfortable and offer a good service because in this case they can offer lower prices and attract more price sensitive guests.

### **c. Occupancy rates of hotels**

In reviewing the occupancy rates of hotels, one can determine whether the existing supply was enough to satisfy the demand for tourism or not.

Table (4.12) lists the occupancy rates classified by categories as well as regions for the period 1987-1989.

From this table, it can be shown that on average the occupancy rates were highest throughout the period for 5 star hotels which were in the 70% range, followed by 4 star hotels that fell into the 60% range and in the end came 3 star hotels in the 50% range.

Furthermore within the 5 star hotels, it can be identified that Cairo hotels attained the highest occupancy rates which reached 76.5% in 1989. Luxor hotels came second with a 71.9% in 1989, whereas Aswan hotels came third with a 66% in 1989, and finally Alexandria hotels attained the lowest rate i.e. 63% in 1989. The reason behind the high occupancy rates for Cairo five star hotels could be explained by the fact that Cairo is not only an attractive tourist city but also a business and trading centre which draws more tourists than other parts of the country. Also as we mentioned before, Arab visitors who ranked second in terms of the number of tourists visiting Egypt and

first in terms of tourist nights, preferred to stay in Cairo. As for Luxor which came second in terms of occupancy rates, this could be easily justified because it is very popular for its tombs and temples on a world wide basis i.e. it contains one third of the world's monuments. Furthermore the recent improvements ventured by the Governorate of Luxor has effected a recent influx of tourism to the city. Finally the occupancy rates for 5 star hotels in Alexandria were lowest due to several reasons. Alexandria is a summer resort and so in winter tourists are very low. In addition Alexandria currently faces severe competition from other new popular regions such as Hurghada and the Red sea area and finally Arabs that visited Alexandria preferred renting flats rather than staying at hotels.

In short it can be concluded that for all hotels/categories, on average the occupancy rate during the last three years lay within the range of 68-69% i.e. 70%.

To have an occupancy rate of 70% for all hotels in Egypt is a very encouraging figure and truly manifests the fact that Egypt in one of the leading countries in the field of tourism.

#### **d. Expected supply of accommodation facilities**

First it should be marked that it will be complex to try to predict the future accommodation capacity based on the figures in Table (4.10) because they focused only on hotels and disregarded the other types of accommodation in Egypt. Also it is difficult to forecast accurately the amount of investment that the government and the private sector intend to allocate for the tourism sector. Thus there was no better alternative



other than to rely on the five year plan of the Ministry of Tourism i.e. Table (4.13) which provided the expected supply of accommodation for the period 1992-1997.

In Table (4.13) the different types of accommodation in Egypt i.e. hotels, tourist villages and floating hotels were given. It can be clearly observed that hotels constituted about 62% of the total accommodation available in Egypt followed by floating hotels i.e. 32% and finally tourist villages i.e. 6%. The same order can be depicted in the case of rooms and beds. In the last part of the table we find that the expected increase in accommodation for the coming five years will be highest for hotels i.e. 43%, followed by tourist villages 30.4% and last floating hotels i.e. 26.5%. However the expected increase in rooms and beds will be highest for floating hotels at nearly 48% followed by hotels at about 37% and finally tourist villages at about 14%. It should be explained that the floating hotels are expected to have more rooms and beds than hotels because the cost of erecting floating hotels is much cheaper than hotels.

#### **5. Future prospects for the tourism industry**

As mentioned earlier tourism presents one of the significant sources of income to Egypt and that is why the government fully realizes the importance of tourism to the economy and places it as one of high priority in its national plan. The tourism's sector previous five year plan 1987-92 aimed at reaching a target of 2.5 million tourists which was achieved i.e. there were 2.6 million tourists at the end of December 1990 despite the negative effect of the Gulf War on

world tourism.

Moreover the current five year plan (1992-1997) of the Tourism Ministry aims at increasing Egypt's share of world tourism by about 5 million tourists and expects earnings from tourism to amount to \$7 billion by the end of 1997, which fairly confirms with our previous findings in Tables (4.7) and (4.9).

According to tourism experts, the tourism sector in Egypt is expected to grow by 15% despite the 1990 slack. The reason behind their strong belief is that the government involvement in the tourism industry has been decreasing further as government holdings in the form of shares in hotels and floating hotels are being sold to the private sector. Therefore one can be sure that the tourism industry will continue to play an indispensable role in the economy of Egypt.

#### **F. Hotel industry in Egypt:**

After reviewing the importance of the tourism sector in Egypt, an overall picture of the nature of five star hotels in Egypt will be now provided. This will allow the reader to be familiar with the various elements of costs and revenues in hotels in order to better understand how their profitability is determined.

##### **1. Five star hotels revenues:**

###### **a. Rooms Revenue**

The first important point that one should grasp about hotels in general, is that the Rooms Department plays a very decisive role in the profitability of hotels. By the norms of the hotel industry, the Rooms revenue is approximately 50% of the total revenues in five star hotels. The **Rooms Revenue** is



calculated by multiplying the **Number of Rooms available for letting by the Average Room Rate.**

It should be indicated that in Egypt, the Ministry of Tourism sets a range of minimum and maximum room rates for each class of hotels which is called the **Rack Rate or Published Rate.**

This procedure is utilized by the Tourism Ministry to ensure that the prices in Egypt are as competitive as those employed by other leading tourist countries. It should be pointed out that the rack rate is always expressed in dollars and it is revised on an annual basis by the Tourism Ministry i.e. October of each year. Usually the rack rate is increased by 10-15% per year. The last rack rate published by the Tourism Ministry for five star hotels was in the range \$70 - \$150 from October 1990 till September 1991. Egyptians are however allowed to pay in the local currency (L.E.) at a 40% discount from the rack rate. Though five star hotels are supposed to use the rack rate as a guide in their pricing policies, the writer was told by several hotel managers in Egypt, that it is common practice for hotels to have an average room rate lower than the rack rate by 20% or more due to the discounts given to the travel agencies, special guests and incentive groups. This confirms what we have already referred to, that hotels in Egypt depend mainly on business contracts with G.I.T. who enjoy the highest level of discounting.

#### **b. Other five star hotels revenues**

The other components of hotel revenues are Food and Beverage revenues and M.O.D. or Minor Operated Departments revenues which include Telephone and Telex revenues, Laundry

and Dry Cleaning revenues, Sports Centre revenues, Casino revenues. Finally the Other Income and Rentals is the last item of revenues earned by hotels, but it is a non operating income such as renting shops or stores.

The standard distribution of revenues and costs for five star hotels as defined by five star hotel general managers will be subsequently given. However the reader should note that this standard could possibly vary from one hotel to the other depending on each one's specific circumstances.

Departmental Revenues	% to total revenues
Rooms	48%-52%
Food	28%-32%
Beverage	14%-17%
M.O.D.	2%-5%
Other Income & Rentals	3%-5%

As one can clearly observe, the Rooms revenue amounts to about 50% of the total revenues of the hotel. Hence one of the key elements to predict the total revenues of any five star hotel is to forecast as accurately as possible the Rooms revenue. Moreover according to hotel experts, the revenues of the other departments can be usually determined as a percent of the Rooms revenue. Another point that can be detected from this table is that the Food and Beverage revenues come second in importance followed by the M.O.D. revenues. Finally it should be pointed out that five star hotels which have a casino, will have higher M.O.D. revenues than what was stated above.

## **2. Occupancy rates**

This is the second element that determines whether the hotel is profitable or not, together with the average room rate. The average annual occupancy rate is the ratio of total



occupied rooms to total available rooms. In addition there is another influential ratio which is the average double occupancy rate which is the total number of guests divided by the total number of rooms occupied. For five star hotels in Egypt, the price for single rooms is 20% less than that of double rooms. As we have indicated before, the occupancy rates for five star hotels lay within the range of 70%-75% which is quite high if compared with other countries. According to the norms of hotel industry, the double occupancy rate is supposed to be 1.3 for business hotels and 1.8 for other five star hotels in Egypt.

### **3. Five star hotels costs**

Usually the costs of a hotel are computed as a percent of its total revenues. The standard breakdown of the various cost elements of a five star hotel as defined by five star hotel managers in Egypt are as follows:

Total Revenue		100%
Food Cost	12%	
Beverage Cost	4%	
M.O.D. Cost	2%	
Payroll Expenses	14%	
Gen & Adm Expenses	4%	
Marketing Expenses	4%	
P.O.M.E.C.	6%	
Other Expenses	3%	
	----	
Total Costs	50%	
G.O.P.		50%

**The glossary at the end of the chapter will provide a detailed explanation of the terminology used.**

Tabit (Interview, February 1992), General Manager of Maadi Hotel, mentioned that there is another detailed way in expressing the total costs of five star hotels which is to subtract each department's revenues from its costs to get each department's profit. Then we subtract from the departmental

profit the overhead expenses or undistributed expenses to arrive at the G.O.P. of the hotel.

1. Departmental Revenues:	
Rooms	50%
Food	30%
Beverage	13%
M.O.D.	20%
Other Income & Rentals	5%
	----
	100%
2. Less Costs: (Out of each item's revenues)	
a. Cost of Sales	
Food	35%
Beverage	45%
M.O.D.	50%
b. Payroll Expenses	
Rooms	10%
Food & Beverage	20%
M.O.D.	10%
c. Other Expenses	
Rooms	2%
Food & Beverage	5%
M.O.D.	2%
3. Total Departmental Expenses	
Rooms	6%
Food & Beverage	27%
M.O.D.	1%
4. Departmental Profits:	
Rooms	44%
Food & Beverage	16%
M.O.D.	1%
Other Income & Rentals	5%
	---
	66%
5. Less Overhead Expenses (Out of total revenues)	
Administrative & General	8%
Marketing	2%
P.O.M.E.C.	6%
	---
	16%
6. G.O.P.	50%

Departmental Profits as a % of each department revenues:	
Rooms	88%
Food and Beverage	37%
M.O.D.	30%

From the above classification, one can realize that the ratio of departmental profit to the departmental revenue is highest for the Rooms department i.e. 88% followed by the Food and Beverage Department which is 37% and then came the M.O.D. i.e.



30%. This once more asserts the importance of the Rooms department in the overall profitability of a hotel. A last point to be reported is that the ratio of departmental profit to the departmental revenue could be higher for M.O.D. than Food and Beverage in hotels that have extra facilities, for example a Casino.

#### **4. Gross Operating Profit (G.O.P.)**

Gross operating profit is the profit earned by hotels after all the operating costs and overhead expenses are deducted so it is the last item in any hotel's accounts.

G.O.P. is used to evaluate the overall performance of hotels. It must be clarified that the G.O.P. ignores all the fixed charges incurred by the hotel such as depreciation charge and interest charge, which are instead included in the owning company accounts.

Hence one can realize that the financial statements for hotels are peculiar because there are two sets of accounts, one for the hotel that ends with the G.O.P. and the other for the owner which ends with the net profit of the hotel after subtracting the fixed charges, taxes and management fees from the G.O.P. In other words the hotel accounts do not recognize the funding expenses of the hotels which instead appear in the accounts of the owning company. This will often result in a paradoxical situation whereby five star hotels are profitable while the owner of the hotel i.e. public sector company is losing due to the burden of the fixed charges.

Finally it should be remarked that the G.O.P. for any five star hotel can be roughly estimated if one knows its Rooms Revenue

because both are approximately 50% of the total revenue. For example assume that there is a hotel with 500 available rooms and its average room rate is L.E. 100 and the occupancy rate is 70%.

Rooms revenues =  $365 \times 500 \times 100 \times 70\% = \text{L.E. } 12.8 \text{ million.}$

Hence one can fairly expect that the G.O.P. will be nearly the same as the rooms revenues.

#### **5. Five star hotels in Egypt and Worldwide**

Since five star hotels, that are chain affiliated, provide a similar service, it is possible to compare them on a worldwide basis. Through comparing five star hotels in Egypt with their rivals in other countries, one can better assess the competitiveness and profitability of the Egyptian hotels.

To perform this task, the publication '**Worldwide Hotel Industry 1991**' by **Horwath International** was used. It should be said that this publication is an annual one which provides detailed information about the current operating and financial trends of the hotel industry grouped by regions that cover the whole world. For our analysis, only four groups were particularly selected i.e. Africa region, Europe region, U.K. hotels and Cairo hotels. Africa region was chosen because Egypt is a country in Africa and therefore it would be useful to see how Cairo hotels rate with hotels in Africa. On the other hand Europe region was selected because it is a major tourist area in the world. In addition U.K. hotels were selected as a representative example of all European countries and finally the average of all five star hotels in Cairo was used because the average for all five star hotels in Egypt was not



available. Nevertheless this will not cause much difference in our results because approximately 40% of all five star hotels in Egypt exist in Cairo.

From Table (4.14), one can realize that Cairo hotels achieved the highest G.O.P. i.e. 51% followed by U.K. hotels which was 33.9% then the Africa region which was 31% and finally came the Europe region with a G.O.P. of 29.5%.

We have previously imparted that both the occupancy rate and the Rooms department revenue determine to a large extent any hotel's G.O.P. Hence we should compare these two factors for the four groups. Consequently one can realize that the occupancy rate for Cairo hotels i.e. 71% was higher than that of other groups i.e. 65%, 65.6% and 64% for UK, Europe region and Africa region accordingly. As for the average room rate, it varied much among the four groups. Europe had the highest room price i.e. \$80.23 followed by the U.K. hotels i.e. \$79.42 then came Cairo hotels i.e. \$63.47 and last was Africa i.e. \$52.84. It can be observed that the average room rate for Cairo hotels was lower than Europe region and U.K. hotels by 26% and 25% respectively.

From Table (4.14) one could view that Cairo hotels ranked first in terms of G.O.P. due to their lower departmental costs and overhead expenses. In particular the Rooms department had the lowest expenses i.e. only 10% of its revenue, next came the Food and Beverage department with departmental costs of 61% of its revenue and last was the M.O.D. department which had costs amounting to 67.5% of its revenues. Consequently departmental profits were divided as follows: 90% for the Rooms department,

39% for the Food and Beverage department and 32.5% for the M.O.D. In addition Cairo hotels had lower administrative expenses which reduced their overall undistributed operating expenses.

In short it can be depicted that Cairo hotels had a G.O.P. that was 1.7 times more than the Europe region and 1.6 times more than the Africa region. Hence one can state that due to the lower departmental costs and administrative expenses, Cairo hotels in Egypt were more profitable than Europe and U.K. hotels despite having slightly lower average room rates.

#### **6. Unique characteristics of the hotel industry in Egypt**

As one can perceive from the last part, five star hotels in Egypt were more profitable than their rivals abroad which certainly gives the hotel industry in Egypt a competitive edge over other tourist countries in the world. This is because five star hotels in Egypt possess certain unique characteristics:

a. Five star hotels add a 17% service charge on top of each bill paid by the hotel guests. This 17% charge does not represent an income to the government but rather it serves as a source of finance for the hotel. It is distributed by the hotel management in this manner:

- i. 60% is paid as salaries to the employees that are in direct contact with the guests i.e. Rooms department, cashier, waiters etc..
- ii. The remaining 40% is divided as follows:
  1. 20% goes to the replacement and renewals i.e. chinaware, linenware, silverware etc..
  2. 15% is paid as extra salaries to employees not



in direct contact with the guests.

3. 5% is paid as incentives based on the discretion of management.

Thus one can realize that five star hotel guests are financing to a large extent the staffs' salaries as well as the replacement cost and renewals of the hotel.

b. The government grants hotels tax holidays for their first five years of operation. After this initial five year period of tax exemption, hotels can be given a 33% tax exemption on profits for another five years if they doubled their capital. These tax concessions are provided by the government to hotels in order to foster tourism in Egypt.

c. G.O.P. could reach 50% and even sometimes 60% for five star hotels in Egypt but it does not exceed 35% for hotels in Europe, mainly due to the lower costs in Egypt.

- i. Low payroll expenses or lower basic salaries paid to employees. According to the General Manager of Luxor Movenpick (Interview, January 1992), in Europe the labour cost constitutes 30-40% of the total cost whereas in Egypt it comprises 10-22% of the total cost.
- ii. Low food cost.
- iii. Energy costs such as fuel, heat and electricity in Egypt are much lower than in Europe. However it should be mentioned that the economic reform measures proposed by the IMF necessitates that energy costs in Egypt should be increased to reach international prices after five years.

iv. Lower maintenance expenses.

v. Occupancy rates in Egypt are higher than Europe.

According to Steel (Interview, July 1991), five star hotels in Egypt achieved an occupancy rate between 70%-75% before the Gulf War, whereas in Europe the occupancy rate was between 60%-65% for the same period.

vi. Staff room rate i.e. number of employees per room for Cairo hotels was 1.6 while it was 0.7 for Europe region and 1.3 for Africa region. Though Egyptian hotels are overstaffed in comparison to Europe and Africa regions, this did not have an adverse effect on profitability because of the lower basic salary earned by employees in Egypt, and the unique 17% service charge on bills imposed by five star hotels in Egypt which finances a large part of the employees' salaries.

vii. The investment cost of five star hotels in Egypt i.e. land, building, fixture and furniture costs are lower than abroad. To further illustrate the costs of steel, cement, gravel finishing material, accessories i.e. building materials as well as labour cost are less in Egypt than Europe.

d. According to the General Manager of Luxor Movenpick (Interview, January 1992), the average room rate in Egypt is still lower than abroad which has definitely helped in making its five star hotels competitive on an international basis. However the cost of staying in five star hotels in Egypt is not



as cheap as it used to be if compared with other countries in the Middle East. Nevertheless since the demand for tourism is higher than the supply of hotels, the five star hotel business will continue to be prosperous.

e. Before comparing the riskiness of five star hotels in Egypt with their international competitors, we will first define risk. Brealey and Myers (1988) stated that risk in investment means that future returns are unpredictable. There are two types of risk, the unique or unsystematic risk that can be eliminated through diversification and market or systematic risk that cannot be eliminated even if we have a well diversified portfolio. According to the CAPM, the market risk of a security or its beta is the sensitivity of an investment's return to market movements. Thus the expected risk premium from an investment should vary in direct proportion to its market risk. Thus investors will demand higher return from investments with above average market risk i.e. the higher the beta, the higher the expected return.

Concerning the tourism sector in Egypt, Hassanein (Interview, February 1992) mentioned that the beta of tourism in Egypt can be assumed to be 1.00 i.e. the same as the beta of the market portfolio. He added that since in Egypt beta for individual sectors is not calculated and the stock market is not sophisticated, beta in this case is an educated guess made by professionals. Furthermore the Tourism Minister announced in Al Ahram on 13/4/90 that the expected rate of return on five star hotels in Egypt will range between 20-40%.

On the other hand concerning hotels abroad, through using

Datastream on 29/10/92, the writer got on average the beta and return on shareholder's equity for hotels quoted on various international stock exchanges. The results were:

Country	Number of hotels	Beta	R.O.E.
U.K.	8	0.406	6.1%
Swiss	4	0.408	N/A
Japanese	4	0.546	4.2%
French	5	0.629	12.7%
U.S.A.	8	0.646	13.7%

- Beta for hotels abroad ranged between 0.40 to 0.65.

From the above it can be viewed that five star hotels in Egypt have a higher beta and higher expected return than those abroad which confirms with the CAPM. Nevertheless one should not rule out the idea that beta of five star hotels in Egypt might be less than 1.00 as their competitors abroad. However this can only be confirmed through actual calculation of beta.

f. The recent efforts undertaken by the government, in specific, providing the necessary infrastructure in new tourist areas like the Red Sea, Hurghada and Sinai areas, have increased the number of tourists visiting Egypt, which in turn has given a boost to the hotel industry in Egypt.

From the above it can be concluded that the unique characteristics present in the DeLuxe hotel industry in Egypt has enabled it to outperform other five star hotels abroad.

#### **G. Conclusion:**

Sultan (1992) summarized the Tourism Ministry's privatisation plan by indicating that the valuation of some five star hotels as well as five tourist companies has been concluded. He added that these hotels and companies will be shortly offered for sale through the stock market. The main



purposes behind privatising those tourism companies and hotels are: to increase the funds available for the tourism sector, to improve the capital structure of tourism public sector companies, to allow Egyptians to become shareholders in profitable companies and to help activate the stock market in Egypt.

As one can observe, the tourism sector is the first sector in Egypt that took positive steps towards privatisation.

That is why the writer decided to use five star hotels as her sample for valuation because it represents a realistic example of the SOEs that will be privatised in the near future. Moreover the required financial information about this industry was more readily available than other sectors. Finally the writer had an excellent opportunity to make several interviews with key personnel involved in this field i.e. top five star hotel management as well as financial consultants that valued hotels both in Egypt and the U.K.

Now we will review the main factors that made the government choose first class hotels for privatisation.

1. The importance of the hotel industry in Egypt lies not only in its ability to provide directly foreign currency earnings to the national budget but also in its nature as an international service that allows Egypt to compete neck to neck with other countries in the world.

2. Being a profitable business, the privatisation of hotels in Egypt can easily attract international investors as well as the domestic private sector because they will earn more than the rate of return they can get from industries of the same

nature and risk, whether locally or abroad.

3. Five star hotels in Egypt satisfy the basic criterion for privatisation as set by the British team of experts which we have stated before in section (C). In other words five star hotels have a history of high profitability even when compared with similar five star hotels abroad. In addition hotels are not strategic businesses that the government might be hesitant to privatise. Any political risk inherent in the hotel industry is faced worldwide and is not limited to Egypt, as was the case in the Gulf War. However contrary to all assumptions and expectations, the tourism sector in Egypt recovered from the relapse caused by the Gulf War and it quickly regained its significant position in the economy.

4. Another advantage that five star hotels enjoy is that their existing management is already private and international i.e. they are chain affiliated with Sheraton, Hilton, Marriott etc.. Hence one can say that five star hotels in Egypt owned by the government are in a way already privatised because management contracts is one form of privatisation.

5. It is evident that the underlying quality of the accounting information is a very crucial factor that should be verified prior to any valuation exercise. However because five star hotels in Egypt are internationally managed, they already adopt internationally accepted accounting principles i.e. the U.S. uniform system of accounting. Therefore the recurrent problem, faced by financial consultants, of having to readjust the figures of the balance sheets and income statements of East European enterprises, was not at all encountered in the



valuation of five star hotels in Egypt.

6. Since five star hotels are profitable and are expected to retain their profitability in the future, they are good candidates for privatisation through the stock market. This will enhance the role played by the capital market which is one of the objectives of the privatisation programme in Egypt.

In conclusion, one can presume that the Egyptian government has decided to privatise first its five star hotels in order to promote its privatisation programme. This is due to the fact that five star hotels in Egypt are easy to privatise because they are profitable, non strategic industries, privately managed, not overmanned and earn more than the expected rate of return even when compared to industries with the same risk and nature abroad.

## Notes and References:

[1] The writer attended **"Privatisation: Techniques and Benefits" Conference** at Cairo Marriott on the 5th and 6th of January 1991.

The guest speakers comprised:

Willets, D.     Director, the Centre of public policy.  
Buxton, A.     Vice Chairman, Barclays Bank plc.  
Asseily, G.     Director, Schroder Group in the Middle East.  
Nicholson, M. Partner, Slaughter and May.  
Benson, P.     Partner, Coopers and Lybrand.  
Helmy, T.     Partner, Baker and Mckenzie in Cairo and Riyadh.

The main issues that were tackled during the conference were:

1. Reasons for privatisation
2. Preparing for privatisation
3. The role of the merchant banker in privatisation
4. The role of the lawyer in privatisation
5. The role of the accountant in privatisation
6. The Egyptian perspective

- Interview with General Manager of Luxor Movenpick, Egypt, January 1992.
- Interview with Steel, P. Corporate Finance Department, Coopers & Lybrand, London, July 1991.
- Interview with Tabit, A. General Manager of Maadi Hotel, Cairo, February 1992.
- Interview with Hassanein, M. Chairman of Aricon Company, Cairo, February 1992.



## GLOSSARY

### Terminology used in hotels

- **Food Cost:** cost of food served to guests and it does not include the cost of employees' meals.
- **Beverage Cost:** cost of beverage served to guests and it does not include the cost of employees' beverages.
- **M.O.D. Cost:** cost of laundry, telephone, health centre and any other M.O.D. sales.
- **Payroll Expenses:** Salaries, wages and employee benefits of personnel in Rooms, F&B and M.O.D. departments.
- **General & Administrative Expenses:** include cash coverages or shortages, executive office expense, collection charges, general insurance, legal expense, commission on credit cards, accountant fees, collection charges etc..
- **Marketing Expenses:** include advertising in all media and applicable travel expenses and supplies.
- **P.O.M.E.C.:** Property operation and maintenance includes the cost of repairing buildings, electrical and mechanical equipment and fixture, floor coverings, furniture etc..
- **Other Expenses:** direct departmental expenses incurred in the operation of a department such as guest supplies, chinaware, glassware, cleaning supplies, etc..
- **G.O.P.:** Gross operating profit of a hotel.

## **Chapter 5 Valuation: an overview**

### **A. Introduction:**

Given the significance of valuation prior to any privatisation, it is important to discuss the various issues related to valuation before we actually value a sample of five star hotels in Egypt in the next chapter.

This chapter will first emphasize the importance of value as a significant constituent for the success of corporations in the next decade. Next the various concepts of value will be defined. Then the various valuation methods used by financial consultants to value a business will be tackled. Further the chapter will reason why the DCF method is a superior valuation method that overrides other valuation techniques. Afterwards the chapter will summarize the critical factors that determine the value of any business. Finally the chapter will conclude by reviewing the problem areas that are involved in any valuation exercise, with special reference, to the developing countries case.

### **B. Importance of value as a key factor to success:**

According to Copeland, Koller and Murrin (1990:3), "today's business environment is rife with challenges ranging from volatile interest rates to decreasing returns to vertical integration that have a major impact on the value of many companies. At the same time investors in capital markets have become less forgiving of substandard performance by managers. Shareholders have become more active in protecting and



furthering the value of their investments and a loose confederation of takeovers entrepreneurs has been extremely successful in displacing some managements and forcing others to restructure to boost shareholder value." Copeland, Koller and Murrin concluded (1990:4) their talk by saying that the "successful companies of the 1990's will be those that make managing value a tenet of their corporate and business strategies. They will be able to take the greatest advantage of the opportunities and threats that confront them, while eluding the raider's grasp."

From the above, it is obvious that shareholder's value is increasingly stressed and has become key to success (Rappaport, 1988). In other words if managers merely concentrated on increasing their market shares or earnings stream, they may unfortunately be heading towards lower cash flows and less value for their companies. On the other hand if they focused on how best to manage their cash flows through searching for the key drivers of value in their businesses, the end result will be success. In short the core element of any corporate strategy is to figure out how the corporation can add value to the businesses it owns, which will be its only and exclusive route towards long term profitability as well as achieving a competitive edge over its business rivals. Hence one can realize that value as a concept has become one of the top priorities to managers in any type of organisation. In other words, value is not limited to cases where the government wants to dispose of its SOEs so it needs to value them; or when a private company thinks of acquiring another business so it has

to value it, on the contrary, valuation has emerged into being one of the principal daily tasks of today managers, if long term success was their goal.

### C. The concepts of value:

Value is a word with many meanings. The word is used in accounting to describe the figure at which an asset or liability is carried in the accounts which may represent something quite different than value as the word is ordinarily used. Thus one can expect the concepts of value to be quite different to accountants, owners of firms and to potential investors.

In theory, there exists several concepts of value which comprise the following: historical value, replacement value, net realizable value, liquidation value, market value, deprival value and intrinsic or economic value.

For a given company the **historical value or book value** of its assets is represented in its balance sheet. According to Norkett (1981), it is the only objective measurement of value because value is not known until an exchange takes place. However one can argue that this is an irrelevant method of valuing because it is based on historic cost of assets which is a bookkeeping practice that relates to the past whereas business decisions relate to the future. Phillips and Ritchie (1983) confirmed that by saying that the asset values recorded in a balance sheet are not utilized in stock valuation theory since they tell us little about the current worth of the company. Nevertheless Brown and Howard (1983) pointed out that the net assets value should not be completely disregarded, in



particular, when management is not employing its assets in an efficient manner which will make the used dividends and earnings capitalization models inaccurate in reflecting the true value of the business. Further the net assets value is often used by sellers as a starting point for negotiating the value of a business.

Next there is the **replacement value** which is the amount that should be paid to replace those assets today. Piper, Rickwood and Samuels (1989) claimed that this measure assumes that the asset will be replaced by an identical product which is unlikely due to the technological and market changes. Further one can find that for some assets, replacement by a modern asset may not be worthwhile or possible which makes the use of the replacement value totally inappropriate as for the case of Marriott hotel in Egypt, which originally was a palace.

Another way to measure value is the **net realizable value** which is the selling price of the assets less the costs of their disposal. This could be a relevant measurement of value because the value of something is what you can sell it for. However businesses do not purchase assets for resale but rather they are bought to improve the future earnings potential of the business. In brief as Piper, Rickwood and Samuels (1989) remarked the problem of the net realizable value is that it abandons the convention of a going concern.

Next there is the **liquidation value** which is the amount that is left over after the sale of assets and the payment of liabilities and liquidation costs. It provides a minimum or the lowest feasible floor, underpinning any less certain or

subjective value from other conceptual approaches. Of course the liquidation value will not be used if the buyer wants to purchase a going concern business. Phillips and Ritchie (1983) confirmed that the liquidation value of the firm's assets will be of little significance since liquidation will usually occur when the firm faces financial difficulties.

Furthermore we have the **market value** which is the market price of the shares times the number of outstanding shares of the company. It should be pointed out that the market value of a company will change very rapidly due to changes in the market price of the company. The latter varies either due to specific announcements that pertain to the company or changes in the general economic or/and political conditions.

Ball and Brown (1968) argued that since capital markets are efficient and unbiased, prices will adjust to information quickly and the market price will be the appropriate value of a particular stock. Further Oyhenart (1991) mentioned that the price traded in the secondary market approaches more realistically the true value of the security as perceived by buyers and sellers. From the above, it is clear that the market value will have a significant impact on the privatisation of SOEs.

Subsequently there is the **deprival value or the value to the owner** which is the loss to the business if an asset is taken away. According to Piper, Rickwood and Samuels (1989), in deciding whether or not to replace an asset, one would attempt to compare the cost of its replacement with the value of its future benefits i.e. economic value. They added that it would



be rational not to replace if the replacement cost exceeded the economic value and in this case the economic value will be the deprival value.

Although we have defined several concepts of value, the most coherent one is the **intrinsic or economic value** which is the present worth to the owners of future benefits from an investment. In other words it is the discounted present value of all future cash flows of a business. The value of the business will depend on the size of the future cash flows generated, the time pattern over which they are to be received, the risk involved, the rate that could be earned on alternative uses of the funds. It should be mentioned that in the calculation of the economic value of a business, one can have two cases i.e. **existing use or alternative use**. In the existing use case, the analyst will assume that the buyer will keep the business as it is, whereas in the alternative use case, the analyst will take into account that the buyer might bring in new things i.e. economies of scale, know how, new marketing strategies etc.. which can yield a higher value for the business than the existing use situation.

Further one should note that the economic value is a forecasted value that could be quite different from the market value. That is why Brealey and Myers (1988) warned that it is easy for the discounted cash flow method to be conceptually and mechanically perfect but practically wrong because its calculation is based upon estimates and assumptions that change.

In short under conditions of uncertainty, one should not expect intrinsic value estimates to be a precise forecast of the

market value since the latter will not be known until an actual transaction takes place. Nevertheless the intrinsic value is the closest one to the market value and therefore will be used in our valuation exercise in the next chapter.

After the above discussion of the various concepts of value, one can become easily perplexed about what is the true value of a business. This is because none of the above methods claims to give an exact figure since this is impossible owing to the inherent nature of the valuation concerned and the numerous factors to be considered, but they serve as a reasonable basis for negotiation.

To finalize our argument about value, we refer to what Glover (1987:2) mentioned i.e. "The value of something cannot be stated in the abstract, all that can be stated is the value of a thing in a particular place at a particular time in particular circumstances. The question 'to whom' and 'for what purpose' must always be asked before a valuation can be carried out." Additionally he explained that in any freely negotiated transaction, exchange will take place if each side stands to gain thereby. In other words the business or property in question must have a greater owner value to the buyer than it has to the seller. Conversely the seller places a higher value on the money or more correctly the things he could buy with money than does the buyer. To proceed with the same line of reasoning, Mullen (Interview, July 1991) asserted that the major determinants of value is whether there exists any existing or potential owner for the business and whether the business generates cash flow. If both factors exist, there is



value for the business.

Applying this to the five star hotel business in Egypt, one would find that five star hotels are commercially profitable and yield the required rate of return i.e. generate sufficient cash flows which will satisfy the criterion of having a greater owner value for the buyer. At the same time the Ministry of Tourism in Egypt places a higher value on the things it can accomplish with the sale proceeds of its hotels i.e. restructuring the balance sheet of the hotels' owner companies as well as developing new remote tourist regions.

#### **D. Valuation methods:**

After discussing in the previous part the concepts of value, we will now present the main valuation techniques used by financial consultants in their valuation exercise. There are basically two valuation methods i.e. Asset valuation and Earnings valuation to value a going concern enterprise plus the other in house methods developed by financial consultants for specific cases.

##### **1. Asset valuation methods:**

Based on the interviews with several financial experts [1], it can be pointed out that the used asset valuation methods in practice include the following:

**a. Historical or Book Value** which is the total assets figure presented in the balance sheet of the enterprise.

**b. Net Assets Value** which is the total assets of the enterprise less its total liabilities i.e. the shareholder's equity or net worth.

**c. Adjusted Book Value** is the current value of the assets

after taking into account the currency deterioration and inflation effects. This is usually effected by professional engineering firms.

**d. Replacement Value** which is how much will it cost now to replace the same asset i.e. what would be paid for it now.

According to Clark (Interview, July 1991), there is no difference between methods (a) and (b), if we assume a company with total assets £100 million, divided into £50 million equity and £50 million debt. The buyer of the company will either pay £100 million to the government if it retains the debt or he will pay only £50 million if he has the burden of the liabilities.

One should note that both the **book value** as well as the **net assets value**, have the problem of stating the assets at their historical or cost value. This drawback could easily undermine the valuation exercise because some of the assets may be fully depreciated and others may be severely undervalued such as the land and building. This explains why financial consultants use the **adjusted book value** method in order to take account of the currency deterioration, depreciation and inflation effects. Though the adjusted book value tries to remedy some of the shortcomings of the other two methods, still all asset valuation methods will be limited in their ability to value a going concern since they focus only on the past records of the company and completely ignore its future prospects.

Finally examining the **replacement value**, one will discover that it should yield the highest value in theory and is used as a bench mark for other valuation methods. However there are some



criticisms of the replacement value as being the highest value of a company. Harris (Interview, July 1991) said that when a business is profitable, one expects its market value to be higher than its replacement cost. In addition Clark (Interview, July 1991) argued that the replacement cost is a measure of cost not a measure of value because it does not provide the answer whether it would be worth to replace the asset or not. For example if the replacement cost of a machinery is lower than its net present value, it would be worthwhile to buy it. Thus the replacement cost alone would not be of much use unless it is compared with the NPV of such investment to determine whether it is a worthwhile investment or not.

After discussing the various asset valuation techniques, one can realize that we cannot depend solely on asset valuation to value a going concern because what is really important is the earning capacity of the asset rather than the asset itself. This concept is widely accepted and favoured by a lot of consultants and scholars. Glover (1987) remarked that the notion that a company is worth its individual assets less its liabilities has no basis in theory or fact. On the other hand, he argued that the value of a company from the shareholders' point of view is driven from its ability to earn profits which arises from the combination of labour (management and employees) and capital (assets). Hence it is erroneous to just look at assets on their own. Furthermore Albeseder (1991) confirmed that value is a function of future earnings and future cash flow. He explained that a business can have many fixed assets but those assets only have value if they generate

cash. However if an asset generates zero cash, it is worthless. Once more the importance of earnings in valuation was affirmed by Clark (Interview, July 1991) who criticized the asset valuation method because it has the inherent danger of neglecting the earning capacity of the assets. He gave an example of some assets in East European companies that do have historic value but were incapable of producing sellable products, which are therefore worthless from the valuer's point of view. Finally some consultants were very radical in their views like Macdonald (Interview, July 1991) who considered asset valuation a useless exercise that should not be undertaken from the beginning.

On the other hand one cannot be blind to the fact that there are certain circumstances when valuers have no choice but to employ the asset valuation method. Glover (1987) argued that the asset valuation method could be employed where the company's assets have a readily realizable value independent of the business. He cited property companies and investment trusts as obvious examples that could adopt this technique. Also Pratt (1981) said that asset valuation is more significant in case of holding companies that have a portfolio of real estate and securities. In addition the IFC report (1991) about the Grand hotel in Czechoslovakia disclosed that the cash flows returns in the hotel industry are not high so that is why hotel investors rely on appreciation in the property value of the hotel to supplement their return, which tends to support the price of hotels when they are sold.

Moreover Gibbon (Interview, July 1991) contended that the asset



valuation method could be used in difficult situations when the required accounting information about the company is unavailable, however he admitted that this method will tend to undermine the value of the company. Finally Epp (Interview, July 1991) agreed that though asset valuation methods do not reflect the true cost of the assets as well as well as the profits, especially in East European companies, valuers would still employ them because of their simplicity, in particular, when the assets are in a very poor condition and require substantial capital expenditure to be able to generate earnings. Also they will be used when it is very difficult to project the future earnings stream accurately in case of East European companies because of the numerous assumptions that have to be made such as the political risk, inflation that changes on a monthly basis, will the government inject the necessary capital to have enterprises with healthy capital structure, will the supply of raw materials be on time or not due to the bureaucracy etc.. All these factors make the financial advisors rely on the asset valuation methods despite their inherent drawbacks.

From the above one can realize that though asset valuation methods have drawbacks, in certain circumstances, they will be used to value businesses. Out of the above mentioned asset valuation methods, the adjusted book value is best since it takes into account depreciation and currency deterioration factors.

## 2. Earnings Valuation Methods:

- a. Capitalized earnings model.
- b. Dividends yield or dividends capitalization model.
- c. DCF or the NPV method.

It should be pointed out that all interviewed consultants agreed that these three methods are utilized by them to value a going concern company, with more emphasis placed on the NPV method. Both methods (a) and (b) represent a kind of stock market valuation i.e. how the valued company compares with other companies in the same industry.

In the first technique i.e. **Capitalized earnings**, past or future earnings are multiplied by a multiplier i.e. P/E ratio which reflects the analyst's subjective judgement about the future growth prospects of the company.

The P/E ratio is the reciprocal of the earnings yield which is widely used on the stock exchange as a tool of investment analysis and appraisal. A company whose shares has a P/E ratio of 12 is rated more than one which has a P/E ratio of 8. Brealey and Myers (1988) remarked that a high P/E ratio shows that investors think that the firm has good growth opportunities, its earnings are safe and thus deserve a low capitalization rate.

The second technique which is the **dividend yield** or the constant growth model by Gordon assumes that value for an investor is a factor of both the future cash flows that he expects from his investment i.e. future dividends plus the capital gain he will earn if he sold the shares.

Therefore  $p_0 = (d_1 + p_1) / (1 + k)$       or       $p_0 = d_1 / (k - g)$   
                    (One period Model)                      (Infinite Dividend Model)



$p_0$  = Current price of the share  
 $p_1$  = Expected next year price of the share  
 $d_1$  = Expected next year dividends  
 $g$  = Expected growth rate  
 $k$  = Required rate of return on alternative investments with the same risk

Thus the price of the shares of a company could be expressed as a function of its expected dividends ( $d_1$ ) divided by the difference between the required rate of return ( $k$ ) less the expected growth rate ( $g$ ).

The third and highly recommended method by all consultants is the **DCF method**. It is widely acknowledged that the DCF method provides a sophisticated and reliable picture of the value of any company when compared to the other earning valuation methods.

That is why a lot of the literature in finance has been written about the NPV method. In order to review the merits and significance of the DCF model, the writer has referred to several books by the following authors: Phillips and Ritchie (1983), Davis and Pointon (1984), Brealey and Myers (1988) and finally Copeland, Koller and Murrin (1990).

In the DCF model the value of a company's equity is defined to be equal to the sum of the present value of the various cash flow streams that ultimately add up to the cash flow of the equityholders. The projected cash flow is equal to the after tax operating earnings of the company plus non cash charges less investments in working capital, property, plant and equipment. It should be noted that the cash flow does not include any financing related cash flows such as interest expense or dividends. The after tax cash flows have then to be discounted to the present at a rate which reflects the

riskiness of the cash flow. The discount rate should reflect the opportunity cost to all the capital providers weighted by their relative contribution to the total capital of the company. The opportunity cost to any investor equals the rate of return the investor should expect to earn on alternative investments with equivalent risk. However when valuing a business, that is assumed to have an indefinite life, there is always the problem of estimating cash flows for an indefinite number of years. This problem is solved by separating the value of the business into two periods, during and after an explicit forecast period.

**Value = PV of cash flow during explicit forecast period + PV of cash flow after explicit forecast period or the residual value.**

Usually the explicit forecast period ranges between five to ten years. As for the residual value or continuing value, it could be calculated through several methods. However one should predict the residual value with prudence since it represents the bulk value of the business and it will change dramatically depending on the used discount and growth rates. Now we will present some technique that can be used to estimate the residual value.

The first method is to estimate the free cash flow for the first year after the explicit period which will be assumed to continue for the indefinite life of the business i.e. normalized cash flows and then divide it by  $(k-g)$ . The second method is slightly different from the first one whereby the normalized cash flows are divided by the cost of capital  $(k)$



only. Brealey and Myers (1988) justify the use of  $(k)$  only as a divisor by saying that as time passes by, the firm and its competitors will be on equal footing when it comes to major new investments. They further clarified that though the firm may be still earning a superior return on its core business, its attempts to introduce new products or expand sales of existing products will trigger intense resistance from competitors who are just as efficient as it is. They concluded that one can safely assume that in the long run as competition catches up, the present value of growth opportunities will be zero. Another method is the P/E ratio approach where one assumes that the company will be worth some multiple of its future earnings in the continuing period. The difficulty lies in the estimate of an appropriate P/E ratio. Some analysts solve this problem by taking the P/E of mature comparable companies whose scale, risk and growth prospects match the company under study. The final approach is the market to book value one which assumes that the company will be worth some multiple of its book value. Nevertheless the problem with this method is deriving an appropriate multiple and the distortion of the book value itself due to inflation and arbitrariness of the used accounting assumptions.

In conclusion, it should be pointed out that there is no best method for calculating the residual value and that consultants rely on several methods. Nevertheless several authors as well as practitioners put more weight on the second method since they believe that after the explicit period management should expect the present value growth opportunities

to disappear.

### **3. Valuation methods used by consultants:**

It was apparent, from interviews with major privatisation consultants, that there were different approaches taken in confronting the valuation problem. Consultants favoured different models and rarely relied upon one dominant technique. Instead they used parallel valuation methods, combining these by judgemental processes in their final advice. Having recommended values, they adopt procedures to test demand through the selling process itself. This results in a 'brand' or in-house valuation style, hereafter summarized.

#### **a. Kleinwort Benson Ltd**

- i. Book binding
- ii. Back end tender

Both approaches use exploration of market values. In the first method, Kleinwort will usually approach separately the various institutional investors in order to be acquainted with the maximum price they are willing to pay for a group of allotted shares before they are formally floated on the stock market Gibbon (Interview, July 1991). This will help Kleinworts to be able to forecast more accurately the price of an issue, before it is offered to the market. On the other hand the second method will be used by Kleinwort as a safeguard in case the share price appreciates at a higher rate than the offer price. This is because Kleinwort makes a pre-agreement with the financial institutions to take at least 20% of the total offering at a predetermined price, before the shares are formally sold on the market. Thus if the price of shares is



different than what is expected, Kleinworts are at least sure that 20% of the offering will be taken by the financial institutions at the pre-agreed price.

**b. Rothschilds**

- i. Managed competitive tender
- ii. Straight auction

Again, Rothschilds sale methods explore potential demand. Epp (Interview, July 1991) mentioned that both methods were used by Rothschilds in their valuation of East European companies, because they cannot depend on the asset valuation since the accounts were distorted and the earnings approach was too difficult to adopt.

In the first approach, Rothschilds prepares a proposal that sets out the financial and non financial criteria that interested buyers have to comment on. For example, if the business to be valued is a hotel, then the information about the hotel is given in the form of a memorandum package to the interested parties. They are asked to submit the price per share and the level of ownership that they are willing to take over. He illustrated that the non financial criteria included how the new owner should deal with the employment issue, whether the new owner should provide marketing and distribution strategies etc.. After that Rothschilds studies the proposals and prepares a list for the government of the interested buyers. Based on the government's agreement, Rothschilds will then provide more in depth information to a narrower list of buyers. The final step is reached when a few interested buyers submit bids that are binding offers and Rothschilds advises the

government on the most appropriate buyer.

In the second approach, a comprehensive package is given to the interested parties on the first meeting. Potential buyers are allowed to visit the site and have a closer look at the assets and the one that supplies the highest bid is chosen. Therefore in this method, the basis for the choice of the buyer depends only on the maximum price whereas the other non financial criteria will be of no weight.

**c. Coopers and Lybrand**

- i. Capitalized earnings
- ii. Net assets value
- iii. NPV

Here there was more concentration upon valuation approaches than to sale. Mullen (Interview, July 1991) explained that in doing valuation, she concentrates on the latest year since it is the most current one and before that the information is meaningless. She also mentioned that she makes use of various valuation methods as a cross check for her final result. She emphasized that those methods should not vary greatly, but should lie within an acceptable range. Finally to be more prudent, Mullen takes an average of these three methods to obtain the company's value.

**d. Egyptian Financial Group**

- i. Book value
- ii. Adjusted Book value
- iii. DCF method
  - 1. Financial (existing situation)
  - 2. Economic (adjust to international prices)



Fouda (Interview, February 1992) remarked that in their valuation exercise, they made use of those four methods and the attained valuation range is presented to the government. He added that they used a ten year cash flow forecast that was based on constant dollars and that the prime rate on the dollar was utilized as the discount rate. He explained that they used this method to avoid predicting the annual increase in costs and revenues since it is a very difficult task, given the complex problem of predicting inflation in Egypt.

**E. Superiority of the DCF over the other valuation methods:**

As indicated in the previous section, the asset valuation method has inherent drawbacks so it should be used cautiously either as a cross check for other valuation methods or in certain situations that demand this type of valuation.

Discussing the other two earnings valuation methods i.e. P/E ratio and the dividend yield, one will find that both are criticized on their theoretical grounds. According to Larcier (Glover, 1987:30) "despite every analyst's intuitive feeling that the earnings do matter, no positive correlation has been found between continuing earnings growth and prices, neither for a sample of stocks nor for a single share over time." Furthermore Glover (1987) disclosed that last year earnings does not mean much in the value of the company. Their significance can only be assessed in the light of the company's dividend policy and its future earnings prospects. He concluded that it is not possible to correctly derive a valuation solely on the basis of the P/E ratio. Further Phillips and Ritchie (1983) indicated that the P/E reported in the newspapers give

a distorted view of the relative value due to the different accounting techniques employed by various firms or the same firm. Thus it can only provide a crude indication of the relative merits of one's investment alternatives and must be used with discretion. Also Brealey and Myers (1988) remarked that the P/E of a firm can mislead investors since it could be distorted due for example to abnormally low current earnings. Moreover Copeland, Koller and Murrin (1990) asserted that the problem with P/E ratio is that it puts more weight on the EPS and ignores other important factors such as the investment required to generate those earnings, timing of those earnings and the riskiness attached to those earnings. They concluded by saying that managers that think they can increase their stock prices through boosting earnings that do not represent any underlying economic change are wrong because the stock market is not dumb and will only react positively to earnings increases that are associated with improved long term cash flow.

Concerning the dividend yield model, sometimes one might encounter an explosive model (when  $k > g$ ) which casts doubt about the model's reliability. Further the dividend yield is based on the prediction of future dividends which is of course a function of expected earnings. The problem however is that it assumes that dividends will be constant, whereas experience suggests that earnings growth rate can vary over time and that firms do change their dividend policy. Furthermore Pratt (1981) mentioned that contemporary business valuation theory and practice put considerably less weight on dividend paying



capacity in arriving at the value of a business. Moreover Brown and Howard (1989) argued that though the dividend yield is a useful guide, it is not sufficient for valuation in itself because the dividend rate may be lower if the firm preferred to retain its earnings and also higher taxes will influence the dividend rate. Finally Copeland, Koller and Murrin (1990) declared that when it is used to compute the cost of equity, the model is flawed and gives incorrect results as opposed to the CAPM or APM. Thus its prediction of value could be questionable because the used cost of equity might be wrong. From the above stated shortcomings of the P/E ratio and the dividend yield model, one becomes more confident about the merits of the DCF method. Copeland, Koller and Murrin (1990) verified that managers who use the DCF approach to value businesses will be rewarded with higher prices, whereas mere concentration on earnings or dividends stream will lead to value destroying decisions.

In conclusion we refer to what was reported by Vuylsteke (1988). He revealed that the practices of using book values, assessing net asset values, calculating the government's total investment or discounting average maintainable historical profits are usually not adequate. On the other hand he argued that using the DCF technique, which is based on forecasts of future performance and expectations of future earnings, can better capture the variety of different factors that any valuation exercise should take into account.

In spite of the merits of the DCF in relation to the other earnings valuation methods, Pratt (1981) warned that it is

difficult to make future cash flow projections since they are based on future uncertain events. He added that the analyst will come up with a range of reasonable values for each company rather than a single value. This range of values will depend on the circumstances of the particular case and the personal judgement of the appraiser.

**F. Critical factors that determine the value of a business:**

One of the inevitable perplexities that face all financial consultants is that valuation is influenced by several factors, which have to be incorporated in their valuation exercise, before they can decide on the value range. The following list will provide the reader with eight necessary points that have to be carefully examined by valuers prior to their valuation exercise.

Clark (Interview, July 1991) specified five factors that affects the valuation of companies:

1. The existence of a strong stock market which reflects the investment sentiment. Vuylsteke (1988) confirmed that the potential market response, in particular the level of investor interest and availability of financial resources, are key determinants to valuation in privatising public sector businesses.
2. The current profit record of the company i.e. its historical or past earnings.
3. The future prospects of the company i.e. its expected earnings which might be different from its past earnings if the new buyer can bring in to the company know-how, economies of scale, new marketing strategies etc.. which can increase the



future earnings of the business.

4. The prospects of the industry to which the company belongs will have an impact on its future profitability. Therefore one can be doubtful about the future earnings potential of a currently profitable company that exists in a declining industry. On the other hand since the tourism sector in Egypt has high growth prospects, this will definitely have a positive effect on the future profitability of hotels.

5. The after privatisation regulatory form adopted by the government will either help or hinder the newly privatised company. e.g. if the Ministry of Tourism sets prices for hotels, this will affect their profitability and vice versa.

6. Vuylsteke (1988) mentioned that the various objectives of the government's privatisation programme will affect the value of its SOEs. For example limitations on foreign holdings or on given groups of purchasers may reduce the value of an SOE. This was confirmed by Gibbon (Interview, July 1991) who said that there are three types of buyers that could be found in privatisation i.e. private investors, institutional investors and overseas investors. He added that the more one can create demand on the issue, the more one will be able to secure a higher price which will be reflected in a higher value for the company. Further Mullen (Interview, July 1991) remarked that the method of sale of the SOE will determine its value. Hence if wider share ownership was sought, one would expect a lower price paid for the shares because of the rather high cost of discounts offered to attract first time small investors whereas if more than 35% of the shares were sold to a certain buyer,

one would expect this strategic buyer to pay a higher price for the gained control. She also mentioned that one would expect lower valuations in case of Employee Share Ownership Plans as opposed to higher valuations in case of private deals.

7. The general business environment will be another important element that affects valuation e.g. a low P/E multiple will be used in practice by investors to value a business if they sense a high level of risk and they will require their money in two to three years. It should be displayed that the general business environment will be affected by the prevailing interest rates, trade regimes, political actions undertaken by the government, existing investment laws etc.. As mentioned in earlier chapters, a business environment that fosters the role of the private sector in the economy, is one of the crucial elements that should accompany Egypt's privatisation programme.

8. Finally Harris (Interview, July 1991) stated that the decision of the government to sell its SOE as a whole entity or in parts will affect its value. It was observed that partial privatisation resulted in higher values for enterprises, for example British Telecom in the U.K.

#### **G. Problem areas in the valuation exercise:**

##### **1. Conflict between maximum value and wider share ownership**

It has been noted in many privatisations that valuation and the resulting pricing involve very sensitive and difficult matters, even where developed markets existed. This is very true especially when assets change hands quickly giving initial buyers large capital gains at the expense of the government's gain.



Vuylsteke (1988) remarked that the French government's sale of shares in the state controlled Elf-Aquitaine has drawn criticism from the opposition socialist party because the opening price set at 305 Francs per share rose to 339 Francs shortly thereafter. He further referred to the case of the Sogenal bank in France, where a premium of 80% was recorded on the first day of trading. In addition he pointed out that the experience of several U.K. offerings have shown even more extreme changes between the offer and trading prices. He continued to say that even in private sales, pricing is very hard and there are cases where despite the introduction of auction based mechanisms, receipts obtained by the national treasury have not been adequate. Finally he confessed that though substantial oversubscription of shares in many public offerings for privatisation in France, Malaysia, Cote d'Ivoire, Jamaica and U.K. have raised questions about their pricing, the pricing itself has been a key element of their success. Furthermore Buckland (1987) asserted that the difference between the offer price of the shares and their market price later was in a way deliberately intended by the British government in order to encourage new shareholders, to generate good will amongst them, to market large quantities of equity quickly and to promote an active aftermarket in those shares. He added that this resulted in relatively high discounting costs as well as bigger administrative expenses such as extensive advertising fees, underwriting fees and legal advice fees. Examining such costs incurred by the British government revealed that privatisation issues were more expensive to

market when they were used as vehicles for the creation of new shareholders. Finally he concluded that criticisms about the government's procedure of sale that led to high costs were counterbalanced on the basis that costs are trivial in the light of the success of its policy of broadening share ownership. Carrying with the same line of argument Jenkinson and Mayer (1988) argued that the costs of discounts in the U.K. privatisations in relation to a range of typical discounts on private sector sales resulted in a £1.9 billion revenue foregone amounting to 10% of the gross proceeds in the U.K. privatisations, which of course represents a high cost to the society.

This was confirmed by Gibbon (Interview, July 1991) who disclosed that the electricity shares were deliberately underpriced by the British government to ensure that a large number of shareholders bought the shares. He added that there will be always a conflicting issue encountered in valuations which is to try to get the maximum number of shareholders as well as the maximum value of the company.

Also Keasey and McGuinness (1992) asserted that though underpricing may be a response to inefficiencies in the price setting process, it is used to create an active secondary market.

On the other hand Vuylsteke (1988) warned that if the shares fell below the offering price as soon as or shortly after they started trading on the exchange, investors will criticize the government and lose interest in further issues and in privatisation per se.



In short Vuylsteke (1988) summarized that different economies will have different objectives from privatisation which will affect their valuation techniques. Thus the British government promoted that the main purpose of its privatisation programme was to increase efficiency and to widen share ownership, whereas the Public Sector Divestment in Singapore has recommended that the sale of shares should not be rushed at the expense of satisfactory prices. The latter of course applies to many developing countries, primarily those who suffer from severe budgetary deficits, where the financial rewards of privatisation will be of paramount importance.

In the end Vuylsteke (1988) advised that if there was going to be a discernible discount for the shares of the SOEs when sold to the public above the normal 8-12% range, governments should endeavour to explain this to the public beforehand so as to avoid the public's criticism of its pricing policy.

From the above one can visualize that governments have to make a compromise between earning the maximum value of their SOEs and having wider share ownership i.e. enhance the role of their stock markets. This will depend greatly on the objective that has top priority in the government's plan.

In addition the conflict between maximum ownership and pricing could be resolved through the use of partial privatisation i.e. releasing shares in successive tranches as pointed out by Buck, Thompsen and Wright (1991). Furthermore Cavazzutti (1990) argued that public authorities should make use of an extensive information campaign to encourage small investors to partake in the share purchase without the intention of short term

capital gains.

Concerning five star hotels in Egypt, partial privatisation through the stock market would ensure wider share ownership as well as maximum receipts for the government without the fear of the drawbacks of partial privatisation i.e. government interference in the operations of the hotels because they are already privately managed.

## **2. The quality of the accounting information**

Tweedie and Whittington (1990) remarked that financial statements, balance sheets and profit and loss accounts, are intended to serve users in their economic valuation and decision making. This implies that accounting measurement should strive to reflect actual economic opportunities and steer towards current valuation and the estimation of future prospects rather than historical cost valuation and concentration on past transactions. Due to the importance of this topic, a lot of literature has been written about the relation between the information content of accounting numbers in specific earnings and valuation or share prices.

On one hand, several authors Patell (1976), Jaggie (1978), Nicholas and Tsay (1979) and Penman (1980) indicated that the earnings forecast disclosures were accompanied by significant price adjustments.

On the other hand skeptics regarding the usefulness of reported earnings included (Fisher and McGown, 1983), Fisher (1987), National Commission on fraudulent financial reporting (1987). Further Lev (1989) argued that the earnings research evidence suggests that while earnings appear to be used by investors,



the extent of earnings usefulness is rather limited which is indicated by the weak, unstable correlation between stock returns and earnings and by the very modest contributions of earnings to the prediction of stock prices and returns. He reasoned that this could be due to methodological shortcomings of the earnings research paradigm, investor irrationality and low quality of currently reported earnings due to biases induced by accounting measurement or/and manipulation of reported data by managers. We conclude this argument by referring to what Garrod (1992) has mentioned which is: "despite the wealth of research that confirms the original findings that there is a significant relationship between accounting measured performance and stock prices, it was generally found that less than 10% of price changes can be explained by changes in accounting measures". Hence Lev (1989) suggested that a change in research direction is required. In other words instead of constructing economic models that try to explain the relation between financial variables e.g. earnings and market price, the nature of financial variables should be examined. This was confirmed by Tweedie and Whittington (1990) who referred to the difficulty of choosing between original historical cost or current market value. They remarked that the problem is the existence of a wide variety of current valuation methods such as replacement cost, selling price and discounted present values. Further they argued that though the choice of a single current value method for all circumstances is important to have standard comparisons, it is unlikely since all methods can be shown to yield meaningless

results in some cases.

In conclusion one can say that in spite of the obvious deficiencies within financial statements, they will be used by financial analysts. As pointed out by Garrod (1992), accounting information is still the only source of valuation information produced by companies.

It goes without saying that the valuation exercise will become more difficult when there are no reliable and accurate accounts i.e. distorted financial statements, which is a problem faced by valuers in East European countries and developing countries. This entails restructuring of the accounts whereby consultants translate existing statements to a western style format so that they can have confidence in the earnings stream of the companies.

### **3. Complex analysis is required in any valuation exercise**

In order to decide on a precise value range for a business, valuers have to undergo quite an extensive and sophisticated task. To visualize how this is accomplished practically, we will present below a synopsis of the valuation assignment executed by Ernst and Young consultants for East European companies. Albseder (1990) mentioned that the first step is to develop and send questions to management covering many items such as the company overview, business lines, production processes, marketing, management team, competition etc.. as well as the financial statements of the company. Next they gather the most recent information on the overall economy of the country and the industry involved. Moreover they collect information on the current investment climate and the impact



of new laws on investment. After that they visit the company to explain to management about valuation and learn about management's own views concerning the business. At this stage, Ernst and Young could then make the necessary changes to the financial statements and calculate the NPV of the company. He mentioned that in their prediction of future earnings, they only assume normalized earnings under the current situation. Afterwards they make use of a sensitivity matrix based on various discount rates and residual values. Finally the most likely value range is recommended to the government based on the assumptions made, inflation risk, business risk and industry risk. This is because value is a function of overall market conditions, industry conditions and specific factors affecting the company.

It should be pointed out that more or less the same steps will be employed by consultants in their valuing of businesses in developed countries, with only one exception, which is having a narrower valuation range due to having more confidence in the cash flow projection. Furthermore and as we referred to earlier, consultants might use more than one valuation method as well as their own unique methods as a cross check for their valuation findings. From the above, one can clearly perceive the involved and numerous steps that are required in any valuation exercise.

#### **4. Valuation is different from the price of an issue**

All financial advisors interviewed by the writer confirmed that the major complexity about valuation is that it requires ample exercise of judgement from them. Clark

(Interview, July 1991) asserted that valuation of enterprises depended mainly on experience and business judgement and as financial advisors gain more experience in valuation, they are able to narrow down the valuation range. However he confirmed that though valuation is based on logical estimates, in the end the market will set the price of shares, which is the intersection between the demand and supply of shares. This is a very important point that the reader has to be aware of which is that there is a difference between the valuation performed by the consultants and the price the shares will be sold at. Oyhenart (1991) stated that the problem is not only that valuation is a technical question of determining the right economic value but also a matter of political sensitivity. To further clarify this point Epp (Interview, July 1991) said that at Rothschilds they will carry out the valuation exercise, but the pricing of the issue will be decided upon by the government, after the advice of institutional investors is sought to get a feel of the market or how much they are willing to pay for the shares. Furthermore just before the issue takes place, Rothschilds make use of road show or pre-marketing to know what the market will bear at that time, which reflects the importance of timing in determining the price of an issue. Also Fouda (Interview, February 1992) indicated that in case of private deals they would present the valuation range of a given business to the government, but the final value of the company will be decided upon after negotiations between the government and the vendor.



## **5. Valuation problems encountered in developing countries**

It goes without saying that as divestiture increases, governments in developing countries have to answer the important question what will be the value of their SOEs. Of course this represents a challenging task for any government. First the government has to decide whether it will sell the assets only and carry the responsibility for its liabilities and then how much should it charge for these assets? Next the government has to decide on the method of sale i.e. private deals, the stock market, management buyouts or employee share ownership plans. If a government decides to sell part of an enterprise's equity via the capital market, several things have to be estimated i.e. how much the share will be worth, to whom will it be sold (domestic or international investors) and what can be done to develop the stock market in order to handle various privatisation issues. On all these questions, no framework exists.

According to Galal (1991), the valuation exercise has largely been left to investment, accounting firms or bureaucrats. As a result, enterprise valuation in developing countries has been determined on the basis of a variety of methodologies i.e. P/E ratio, negotiation, the highest bid, replacement cost of capital and DCF. He argued that though each of these methods has its own merits, it is not clear whether these applied methodologies correspond to developing countries conditions or reflect the well being of society especially in situations where capital markets are underdeveloped and relative prices are distorted.

Further Redwood (1990) stated that many SOEs in Eastern Europe have totally inadequate accounts so it is no good to search for perfect valuation and no good to wait for the enterprises to be in a shape suitable to be run profitably. Rather valuations have to be realistic enough to encourage domestic entrepreneurs and western technology partners. Also Willetts (1990) mentioned that the book value of East European industries is meaningless and there is no point in delaying privatisation by pursuing some ideal theory of how an industry should be valued. He added that to be privatised, firms have two real values. The first is what the local market is prepared to pay and the second is the world market price if they are open to anyone to bid. Discussing in depth the valuation problems in East European countries, Young (1991) remarked that net assets value based on balance sheets numbers have little credibility in valuing companies. For example in East Germany, plant and machinery were often amortized for decades to inflate overall valuations, even though the equipment was barely usable after just a few years. In Hungary, receivables do not always represent the enforceable rights that they are in the West. Also the term auditing should be used with caution as auditors' main task was to verify whether production plans were met or not. He added even if accounting data are audited by a Western firm, there is the problem of converting their currencies into dollars. As for DCF and P/E ratios, he said that the usual difficulties of employing those approaches are compounded by staggering economic and political uncertainties. For instance how can one estimate discount rates if capital markets are underdeveloped,



how future cash flows can be projected for companies that have never operated without subsidies, how to estimate earnings multiples in the absence of an active market etc.. He concluded his argument by saying that a meaningful valuation is unlikely for East European companies until capital markets have taken proof, enterprises are put on a commercial footing and a record of privatisations is available.

Finally the World Bank Report (1992) asserted that an overemphasis on valuation can prove problematic. This is because technical appraisals seldom estimate correctly the market price of assets that have never been traded before. It added that valuations will be more difficult in developing countries: due to the rapid changes in the macroeconomic and operating environment e.g. number of bids over the asking price for one of Mexico's airlines went from zero to seven after the government signed a debt renegotiation agreement, financial data are of poor quality and reliability e.g. Argentina's Telecom was sold with poor financial statements, existing accounts do not conform to acceptable standards e.g. East Europe and Central Asia, overpricing leads to failure e.g. 65% of the shares of United Motors in Sri Lanka remained with the underwriters which undermined small investors confidence in public issues, comparables are few and the market thin e.g. East Europe.

Next the writer will summarize some of the practical problems that would be encountered if analysts utilised the DCF model in developing economies:

- In projecting future cash flows, Clark (Interview, July 1991)

said that it is better to have a five year analysis in case of uncertainty and one should exclude exceptional years that have unusual losses or gains. In addition he emphasized that the estimation of future cash flows is not a mere mathematical exercise but rather an art because it relies on the consultant's judgement concerning the expected changes of every item of the cash flows of the company e.g. why and how earnings could be increased and if they are increased what will be the expected effects on costs, working capital, debt etc..

As one can note if SOEs are not keeping accurate and updated financial statements or/and not adhering to the Generally Accepted Accounting Principles, the prediction of future money cash flows becomes extremely difficult. The problem will be intensified if inflation is unknown, unpublished and increasing. To avoid predicting inflation, Egyptian Financial Group Company forecasts real cash flows and uses the dollar in calculating the discount rate.

- Estimating the rate of growth of dividends and earnings will be hard because of the doubt one has about the underlying quality of the accounting information. Further the analyst should take into consideration that the buyers of going concern businesses will not be willing to invest unless they expect a higher return on their investment. This means that buyers expect a higher growth rate after privatisation which have to be incorporated in the valuation exercise. In estimating what the new growth rate could be, the analyst has to investigate various factors which can affect the future growth of the company's earnings such as its market share, product quality,



suppliers, competitors, future expansions, general economic conditions in the country and will the government offer the company a preferential position after it is privatised or not.

- Estimating the rate of return on equity or the cost of equity capital for the privatised firm will be hampered if there is no stock market or if the existing capital market is inactive and underdeveloped. In this case, the published prices of listed securities will not represent the true value of the companies..

- Estimating the discount rate or the rate of return on similar alternative investments will be difficult if one uses the CAPM since it will depend on estimating the appropriate market risk premium, riskless rate of return and beta of the stock. This is a tiresome process because a lot of assumptions have to be made in order to estimate those three variables as accurately as possible. In the end some valuers will tend to use a higher discount rate to allow for the country risk whereas others prefer to use a lower discount rate because they think that it will be less risky for international investors if they invested outside their countries.

## **H. Conclusion:**

In this chapter we have discussed valuation from both the academic and practical point of view. It was indicated that value is a crucial factor for the success of organisations. Next we discussed the various concepts of value and how they are applied by consultants in their practical valuations. In particular we explained why the DCF method is preferred by a lot of consultants as a valuing technique. Finally we defined

the crucial factors that affect any valuation exercise and the problem areas encountered in any valuation exercise.

Reviewing the main issues that pertain to valuation, the reader will now be in a better position to understand the valuation exercise that will be effected for a sample of three five star hotels in Egypt in the next chapter.



## **Notes and References:**

[1] The writer has interviewed several financial consultants, hotel managers and experts in England and Egypt in both 1991 and 1992. She made use of open ended, non structured interviews about valuation concepts, methods, problems etc.. and then hotel valuation, in specific. The firms in England included: Coopers & Lybrand, Ernst & Young, Rothschilds, Kleinworts Benson, Barclays de Zoete Wedd, Horwath International, Hyatt International Hotel, Robert & Barry Co., Gardiner Cheobald. In Egypt the firms comprised: Egyptian Financial Group, Aricon, Citi Bank, Misr International Bank, Misr Hotel Co, Maadi Hotel, Semiramis International, Movenpick Luxor and US Agency for International Development.

- **Interview with Clark, D.** Privatisation Director, Barclays de Zoete Wedd, London, July 1991.

- **Interview with Harris, P.** Senior Consultant, Ernst & Young, London, July 1991.

- **Interview with Macdonald, N.** Privatisation Director, Ernst & Young, London, July 1991.

- **Interview with Gibbon, H.** Corporate Finance Department, Kleinworts Benson, London, July 1991.

- **Interview with Epp, B.** Corporate Finance Department, Rothschilds, London, July 1991.

- **Interview with Mullen, M.** Partner, Coopers & Lybrand, London, July 1991.

- **Interview with Fouda, M.** Partner, Egyptian Financial Group, Cairo, February 1992.

## **Chapter 6 Valuation of three five star hotels in Egypt**

### **A. Introduction:**

The chapter will first start by reviewing the various valuation methods that apply to the hotel industry. Then a value range for three five star hotels in Egypt i.e. Cairo Marriott, Cairo Sheraton and Aswan Oberoi will be calculated. In order to value these three hotels, the writer made an extensive financial analysis on their accounts for the period 1986-1990. As a result, a five year forecast for their future cash flows was determined for the period 1993-1997 and consequently the NPV for each hotel was computed. Further the writer used another three valuation methods to value these hotels i.e. Room rate method, Capitalized earnings method and Room replacement method. Nevertheless due to the various assumptions incorporated in the valuation exercise, it does not provide a final value for a hotel but rather it will set the floor against which the actual value will be determined. Thus the final value will be only determined upon the sale of the hotel. Finally the chapter will conclude by conducting a sensitivity analysis in order to examine how the NPV of each hotel responds to changes in five of the used variables.

### **B. Valuation methods for hotels:**

In general the valuation of hotels will not differ very much from the valuation of any business. However there are some valuation methods that are peculiar to the hotel industry. Harris (Interview, July 1991) mentioned that the DCF method is



used to value hotels and in this case the projections of the future earnings of a hotel will depend on the average rate per room, occupancy rates, departmental costs, discount rate etc.. Gibbon (Interview, July 1991) added that the valuation of hotels is based upon their ordinary stream of earnings plus adding an extra multiple of earnings after comparison with similar hotels on the stock market. Furthermore Mullen (Interview, July 1991) suggested that five star hotels in Cairo should be compared with other hotels on Cairo Stock Exchange as well as with their competitors on other international stock exchanges. In addition Clark (Interview, July 1991) said that hotels could be valued based on how other comparable hotels were sold for recently. Another method could be the replacement cost per room. Furthermore he added that they could be valued if they were run by another management other than the government. Epp (Interview, July 1991) indicated that hotels could be valued using the net assets value, the P/E ratio or the amount of revenue generated per room.

Finally we will display the various hotel valuation techniques employed by Coopers and Lybrand, financial consultants, who advised the Ministry of Tourism in Egypt on the valuation of some of its five star hotels. Steel (Interview, May 1992) listed the main valuation methods that are used for hotels:

#### **1. Room Rate Method:**

**It is the amount per room based on how other hotels were sold in similar areas.** Steel (Interview, May 1992) hinted that by rule of thumb, which is not a definite figure, top five star hotels on an international basis will be sold for \$100,000 per

room. Chan (Interview, June 1992) however argued that five star hotels in the U.K. are sold for approximately \$200,000 per room. On the other hand Parkinson (Interview, June 1992) argued that the price per room will differ from one city to the other. He further added that the figure \$100,000 per room will be regarded on the lower side now, on the contrary, one would expect the price per room for five star hotels to range between \$200,000 - \$500,000. The higher figure applies to Deluxe hotels that have super property and location. He gave examples of such Deluxe hotels which included George V in Paris, Penta House in U.S.A., Nile Hilton and Semiramis Intercontinental in Cairo. From the above, one can observe that consultants on the whole agreed that the market price per room for five star hotels will be roughly \$200,000. Super property Deluxe hotels will realize higher prices that could reach \$500,000 per room or more.

## **2. Capitalized Earnings:**

In this case the **net earnings after tax are multiplied by the P/E multiple for hotels.**

George (Interview, June 1992) mentioned that there is another method used by their firm i.e. Robert Barry & Company, Chartered Surveyors, which is the **Profits Method**. In the Profits Method, one multiplies the **net profit before depreciation and interest times the Years Purchase i.e. YP or a % return**. The YP could be viewed as an another definition for the P/E ratio, because he said that five star hotels that are luxurious and located in city centres would have a 5% or a YP of 20, whereas other riskier hotels might have a 15% or YP of 6.5. In other words the lower the risk, the lower the % return



and the higher the YP, and vice versa.

Steel (Interview, May 1992) mentioned that the P/E for hotels on London Stock Exchange ranged between 15-20 on May 1992. Parkinson (Interview, June 1992) stated that the P/E multiple is 15 for the hotel industry in the U.K., whereas Chan (Interview, June 1992) remarked that it was 14.

Through using Datastream on 21 May 1992, the writer found out that on average the P/E for hotels quoted on London stock exchange was 13.7 for 55 hotels. The same exercise was conducted on various stock exchanges and the results were as follows:

i.	P/E for French hotels	= 17.8	yield = 5.6%
ii.	P/E for Swiss hotels	= 16.5	yield = 6.1%
iii.	P/E for American hotels	= 23.7	yield = 4.2%
iv.	P/E for Japanese hotels	= 56.0	yield = 1.8%

Since the P/E ratio is the reciprocal of the earnings yield, then the higher the P/E, the lower the yield and the higher the value. According to the risk and return model, the higher the discount rate, the higher will be the risk attached to this investment which will result in a lower NPV and vice versa. It is apparent from the above P/E ratios that the hotel business is less risky in Japan and U.S.A., while it is more risky in England and Switzerland.

### **3. Room Replacement Cost:**

**It is the cost of building the hotel now.** It provides the ceiling or the highest value that could be paid by buyers in theory.

Throb (Interview, June 1992) stated that the replacement cost for a five star hotel in London with about 300 rooms would range between £100,000 to £120,000 per room i.e. \$180,000 -

\$216,000 (£ = 1.8\$ ). He asserted that this depended mainly on the location of the hotel. For example cities like Birmingham and Manchester will support hotels with this price but this will not be suitable for places like Bristol. Chan (Interview, June 1992) mentioned that the replacement cost for five star hotels will be approximately \$200,000 per room i.e. £111,111 which is the same figure that she stated for the market price of five star hotels.

George (Interview, June 1992) said that for prime locations the replacement cost could reach £150,000 per room in London i.e. \$270,000, whereas in places outside London, it will range between £80,000 to £100,000 per room i.e. (\$144000-\$180,000). Finally in order to view the other side of the picture i.e. the cost of hotels in Egypt, we referred to a study that was concluded by the Export Development Bank in Egypt in 1990 which has specified the following factors as being crucial in determining the cost of a hotel:

1. Type of accommodation: hotel or tourist village or a cruise.
2. Required standard: 5 or 4 or 3 star hotel.
3. Location: its effect on the availability of labour, raw material, infrastructure during the time of the hotel's construction. At the same time, location will be a source of attraction when the hotel is built e.g. viewing the Nile or the beach.
4. Land cost: it will differ according to the location. Thus the cost of land in Cairo viewing the Nile could exceed L.E. 10,000 per square meter, while it can be as low as L.E. 10 per square meter in certain remote areas.



5. Foreign component cost: the higher this item, the higher the investment cost because of the higher import duties on imported material.

6. Cost of engineering consultancy firm: it will depend whether it is a local or foreign firm. In Egypt, the fees paid to foreign consultancy firms may amount to roughly 15% of the total investment cost of a hotel.

7. Quality of the contractors: this will depend on the cost they will charge which in turn will influence the overall cost of the hotel.

8. The management's role during the construction period: if it was a foreign chain that will run the hotel later, they will require a certain standard for room space, lay out of the hotel, furniture, restaurants etc.. which will in turn increase the fixed costs of the hotel.

9. Interest during the construction period: this will depend on the amount of loans that the hotel gets and the interest levied on them. This is a very critical element in the profitability of hotels. Steel (Interview, May 1992) stated that though hotels are cash cows, they are financed by high leverage, which is a major constraint that limits hotel investment in general.

10. Working capital for the hotel: this will depend mainly on management's efficiency in ensuring that the suppliers provide the required material on time.

It should be pointed out that these factors not only affect the cost of building a hotel but also will help valuers when they are deciding on the replacement cost of a hotel.

Finally to give the reader a feel about the replacement cost for hotels in Egypt, we refer to the same study by the Export Development Bank in Egypt which stated that the cost per room for five star tourist villages in the Red Sea ranged between \$40,000 - \$65,000. Furthermore Doheis (Interview, January 1992) said that the cost of Semiramis Intercontinental, the latest Deluxe hotel in Cairo, was L.E. 150,000 per room in 1987. Assuming that the rate of inflation in Egypt is 25% annually based on the World Bank estimates, then the cost per room for five star hotels in Cairo in 1992 would be approximately L.E. 458,000 i.e. \$136,600 (Using May 1992 exchange rate 1\$ =3.35 L.E.).

Comparing \$137,000 with what we have just mentioned about the replacement cost for Deluxe five star hotels in London i.e. \$270,000, it can be inferred that hotels are much more expensive in London than in Cairo. In other words the replacement cost for hotels in London is about 97% higher than that in Cairo.

#### **4. Alternative usage method:**

It is the cost of redeveloping the property in order to earn a higher value. Steel (Interview, May 1992) mentioned that this method is used for hotels at the lower end of the market. On the other hand Parkinson (Interview, June 1992) argued that it could be used if one considered changing the hotel into something else e.g. office block and in this case it could yield a higher value, especially if it was in a super location.

#### **5. Discounted Cash Flow Method:**

It is the most widely used method. In this technique one



forecasts the expected future cash flows of the hotel and then discounts them to the present using a discount rate that reflects the riskiness of those earnings.

As one can clearly see the five methods mentioned by Steel (Interview, May 1992) encompass the other methods previously summarized by the other financial advisors. Before finalizing our discussion about the various hotel valuation methods, it should be pronounced that there are some critical factors that will determine a hotel's value. First if a hotel is run down and its earnings are depressed but it has a prime location, it is better to sell the hotel as a property since in this case one will get a higher price than if it is sold as a going concern. Steel (Interview, May 1992) referred to **Cairo Sheperd** hotel that has poor cash flows but still could be sold for a higher price than its net present value because it has a prime location overlooking the Nile. In addition there are certain situations when you sell the hotel as a business plus any extra land surrounding the hotel. In this case investors will be willing to pay a higher price for the hotel than its market value because they not only will buy the hotel but also the spare land. In other words surplus assets such as adjoining land and buildings will add to the value of the hotel. This could be depicted in the **Cairo Meridien** hotel which was sold in 1991 for \$75 million, where it was said that the paid price included the value of the adjacent land to the hotel. In this type of valuation, financial consultants have to make use of property/real estate valuers to estimate the current value of the land and buildings.

An important point to be noted in valuation is that the price that the **sophisticated investor** will be willing to pay for a company will not exceed the return he expects to earn from it in the future as remarked by Steel (Interview, May 1992). On the other hand the **strategic buyer or purchaser** will be willing to pay more than the market value of the business and more than would be paid by the sophisticated investor because he will either get into a new market or gain a higher market share via this sale.

Applying this to the hotel industry, a strategic buyer will pay a price higher than the earnings of the hotel because he might be looking for a prime location or a well known name and therefore he will be ready to pay over and above the market rate to get this flagship. Steel (Interview, May 1992) however professed that there are very few strategic buyers who would pay higher than the worth of the business and in most situations one would rather encounter sophisticated investors who will not pay more than what they expect to get later.

Finally when asked how would hotels that have historical buildings be valued, Steel (Interview, May 1992) answered that an independent valuation of the building should be undertaken which should act as a cross check to the DCF method.

### **C. Valuation of three five star hotels in Egypt:**

#### **1. Introduction**

First it should be mentioned that the writer did not choose the sample but it rather depended upon the availability of financial statements at the source from which the information was brought from: that is, the Information Centre



at the Prime Minister's Cabinet. The second thing, is that the three hotels that will be valued i.e. Cairo Marriott, Cairo Sheraton and Aswan Oberoi are owned by the same company i.e. Egoth which is one of the three largest public sector enterprises in the tourism sector. Egoth is quite a gigantic enterprise that owns about eight five star hotels, several Nile Cruises, a hotel management school, other related projects, plus surplus land. A final point to indicate is that two hotels of our sample i.e. Sheraton Cairo and Oberoi Aswan together with three other hotels will be privatised in the near future through the Egyptian exchanges as announced by the Minister of Tourism in May 1992.

In the next section, a similar analysis will be conducted for the three hotels under study. First we will examine their past performance. Then a five year cash flow projection (1993-97) will be done to reach their NPV based on certain assumptions. Also the three hotels will be valued using three other valuation methods.

## **2. Cairo as a tourist city**

Before analyzing the financial statements of the two hotels that lie in Cairo, a short summary will be given about the city of Cairo. This is important because the demand for tourism as well as the influx of tourists to Cairo will undoubtedly affect the occupancy rate of Cairo hotels and their profitability.

The Travel Guide (1989/90) by Berlitz remarked that around every corner in Cairo and at the ancient sites throughout the country, there are constant reminders of the significant

contribution Egypt has made and is still making to the web of history. In particular it described Cairo as the heart of modern Egypt besides being the cultural capital of Arabic civilization. Needless to say there are a lot of places that tourists can visit in Cairo such as the Pyramids, tombs at Saqqarah, ancient site at Memphis, Egyptian museum, Salah El Din's Citadel, famous markets of Khan El Khalili, Mosque of Amr, Fortress of Babylon as well as the old Coptic churches and monasteries that date back to the first century. All these diverse tourist attraction sites besides the numerous entertainment facilities such as theatres, cinemas, casinos, night clubs, exhibitions etc., plus being an international business centre, would serve to make Cairo a thrilling and unique place for tourists and businessmen.

### **3. Cairo Marriott Hotel**

#### **i. Description**

It is the only hotel managed by the international U.S. chain Marriott in Egypt. The hotel has started operation since 1983 and since then it has been commercially very profitable. Marriott, which overlooks the Nile, lies in Zamalek, one of the prestigious residential areas in Cairo, ten minutes from the city centre by car. Marriott's history is intriguing because it was originally a palace that was used for a very special occasion i.e. to accommodate the French Queen when she came to attend the opening ceremony of the Suez Canal in the 19th century. Now the palace is still existent and it comprises the main building of the hotel which includes the front office desks, top management offices, restaurants, coffee shops, a



ball room, banks, shops etc.. In addition there are two parallel towers on each side of the palace which include the guest rooms. Marriott's total room capacity amounts to 1147 rooms which is at the high end if compared with other five star hotels in Egypt or abroad.

#### **ii. Occupancy and Average Room Rates**

As we have indicated in the previous chapter, there are two critical factors that determine the profitability of a hotel i.e. its occupancy rate and average room rate.

Looking at Table (6.1), we note that these rates were not available for years 1986 and 1987. However Marriott's occupancy rate was 72% in 1988 which was slightly increased to 72.7% in 1989 and then it was somewhat reduced to 69% in 1990 due to the Gulf War. As one can observe, Marriott's occupancy rate is nearly 70% which is high if compared with five star hotels abroad (60-65% range) but it is low if compared with other five star hotels in Cairo that had an occupancy rate of 80%.

Concerning the average room rate, it was L.E. 146 in 1988 and then it increased to L.E. 167 in 1989 and finally it reached L.E. 189 in 1990. Hence the increase in the average room rate was 14% in 1989 and 13% in 1990. If we disregarded 1990 as an exceptional year, we will find that when compared to other five star hotels, Marriott ranked fourth out of the thirteen five star hotels in Cairo in 1989. The highest average room rate i.e. L.E. 204 was charged by Semiramis Intercontinental, followed by Nile Hilton L.E. 201, and third came Sheraton Gizera L.E. 195. The difference between Marriott's average room rate and the other three hotels was 22%, 20% and 17%. As one

can see the variance between Marriott and the three hotels was quite high.

In trying to explain the reasons for the high average room rates charged by those three hotels, one will find that the Intercontinental, which overlooks the Nile and is just a few minutes walk from the Nile Hilton, is the latest city centre hotel built in Cairo. As we reported earlier the cost per room was L.E. 150,000 for Intercontinental and in order to recapture such high cost the management need to charge higher prices. Concerning the Nile Hilton, it is the first five star hotel that was built in Egypt in 1959. It commands a unique and prime location overlooking the Nile and it is famous for its spacious rooms. Also it is considered a business hotel that is favoured by international businessmen which makes it enjoy a high annual occupancy rate i.e. 90%. Finally though Sheraton Gizera is not located in the city centre, it is within very easy access to it i.e. five minutes by car. Also it is within walking distance from the new Opera House. Sheraton Gizera is a modern round tower that is built in such a way that part of the hotel is virtually surrounded by the Nile but its rooms are not as spacious as the Nile Hilton.

Reviewing Marriott hotel, one can note that being a palace, the main building is grand and magnificent. In addition it is surrounded with spacious gardens and ornamented with fine artistic statues as well as having a ball room "Aida" that is famous all over the city for its majestic style and decorations. Hence Marriott can command a premium price higher than the current one and arguably equal to that for the



Intercontinental. One reason for a lower than average room rate, is that Marriott has a large number of rooms and in order to secure a higher occupancy rate, given the severe competition among five star hotels, management may accept a lower room rate. Another reason might be the inadequate marketing efforts undertaken by Marriott's management in securing in advance contracts with their associate international tour operators. According to the general manager of Movenpick Luxor (Interview, January 1992), the average room rate of a hotel is determined by four elements i.e. amount of business abroad, currency exchange rates, demand for tourism and the hotel's contracts. As one can depict, most five star hotels in Egypt will face the first three external conditions whereas the difference in each hotel's profitability will depend on its ability to react to those conditions through securing enough business contracts. Thus the writer trusts that if Marriott employed more aggressive marketing strategies, there will be a scope for increasing both its occupancy and average room rates.

A last point that should be referred to in this part is that though the Gulf War had a negative effect on World tourism, in Cairo its effects were less felt because a lot of Arabs were already spending their summer at Cairo when the war started and naturally they extended their stay till the end of the war. This explains why five star hotels in Cairo did not have a large drop in their occupancy rates in the 1990 season.

### **iii. Departmental revenue as a % of total revenue**

It should be indicated that the hotel's overall performance can be mainly analyzed through its operating or

income statement. Its balance sheet will not be of much use except to show how its working capital was financed. This is because the balance sheet does not include all the fixed charges incurred by the hotel such as depreciation, rent and interest which will appear instead in the owner's accounts. Table (6.2) gives us the operating statement for Marriott over the period 1986-1990. It should be mentioned that in our forthcoming analysis, more emphasis will be placed on 1989 rather than 1990 since the later was an exceptional year due to the Gulf War. As one can observe, the operating statement is divided into four parts. The first one displays the gross revenues earned by each department whereas the second shows the departmental costs. The third part shows the overhead expenses or undistributed expenses that cannot be allocated per operating department. Subtracting the departmental costs and overhead expenses from departmental gross revenues gives the G.O.P. of the hotel. The last part presents the division of the hotel's G.O.P. into management fees and the owner's profit. There are several points that the reader should note in the operating statement of the three hotels. The first thing is that the writer obtained the owner's expenses from the Tourism Public Sector Authority because in Egoth's income statement there is no allocation of the owner's expenses per hotel, but instead they have a total figure that include the fixed charges for all Egoth's activities. Kolta (Interview, February 1992) confirmed that it is very difficult to get the financial charges for hotels from the owner's accounts especially if it was for a period of five years. He suggested that the aggregate



owner's expense figure in Egoth accounts could be allocated per each hotel on the basis of the hotel's total investment or its gross revenue. He added that the basis of allocation will differ from one consultant to the other. The second and related issue is that Egoth does not pay taxes on each hotel's net profit separately but it pays taxes after all its fixed charges are deducted. Examining the income statement of Egoth, the writer found that it paid negligible taxes if compared with any of its hotels' profits. This is due to the high interest charges paid by Egoth that leaves it with a much lower profit to be taxed.

Finally Hany (Interview, February 1992) confirmed that in the estimation of the future cash flows of hotels, one should neglect the fixed charges of the hotel and make use of the G.O.P as the net profit. He explained that this is because the new buyer will buy the hotel not its liabilities or loans, which were originally decided by the government. Further one should assume a new capital structure for the hotel under new ownership. He added that depreciation charges are useless since the rates used were low and that the historical net asset value of the hotels were insignificant since they are highly undervalued. Hence one can conclude that the fixed charges of the hotels will not be of much use in our valuation exercise. Examining Table (6.3) one will find that all departments without exception experienced a growth in their revenues which is shown in the overall % change over the period i.e. 1986-1990. The highest increase was surprisingly for the Garage's revenues that amounted to 294.1%. This should not mislead the

reader because the Garage revenues were originally minimal so the slightest increase was magnified. This is confirmed in Table (6.4) which gives the ratio of each item of revenue and cost to the total revenues. As one can see, the Garage revenues comprised only 0.2% out of Marriott's total revenues in 1989. Therefore in fact it was the Rooms department that ranked first in terms of revenue i.e. 135.9%, followed by the Tel and Tlx department i.e. 135.1% and then the F&B department i.e. 115.7%. From Table (6.4), one can perceive that the weight of the Rooms department to the total revenue was 40.9% in 1989 which was the highest compared to the other departmental revenues. From our previous discussion in chapter (4) about five star hotels in Cairo, we mentioned that the Rooms revenue represented about 50% of the hotel's revenue. In case of Marriott, the Rooms revenue was 22% less than the standard for five star hotels in Cairo. This is because Marriott has a lower occupancy rate i.e. 70%.

Coming to its F&B department, it comprised 26.3% of the hotel's revenues which was also lower than the standard for five star hotels i.e. 37%. However Marriott compensated this by the higher revenues attained by its Casino i.e. 19% of the total revenue.

It should be pointed out that there are few hotels in Egypt that have the leisure facility of a Casino. According to the General Manager of Movenpick Luxor (Interview, January 1992), though 50% of the Casino's profits are payable to the state as taxes, Casinos improve the overall profitability of a hotel to a great extent so that it can easily attain a G.O.P. that



exceeds 50%.

A final point to note is that in general one should assume that Casino's revenues for hotels will fluctuate greatly because this depends on the nature of tourists/visitors using the Casino, whether they are gamblers or not. For example if an arab loses one million pounds in one night, this will represent an exceptional gain for the hotel.

Looking at the M.O.D. revenues, which embraces the Tel & Tlx, Laundry & Dry Cleaning and Sports, one can discover that they achieved 7.5% out of Marriott's total revenue. This was slightly lower than the standard for M.O.D. revenues for five star hotels i.e. 8%. Finally the Rentals and other income revenue amounted to 6.1% of Marriott's total revenue which exceeded the standard for five star hotels i.e. 4%.

As one can note, though Marriott was below the standard for five star hotels in terms of the Rooms and F&B revenues, its Casino revenues compensated for the above inadequacies.

#### **iv. Departmental costs**

Discussing the departmental costs from Tables (6.3) and (6.4), it can be depicted that the Rooms department had the highest overall % change over the period 1986-1990 i.e. 137.3%. However the rate of increase was not consistent, thus it increased by 25.8% in 1987, then the rate of increase was slowed down to 19.7% in 1988, then it once more was increased by 24% and 27.1% in 1989 and 1990 accordingly.

Concerning the F&B department, it ranked second in terms of the increase in its costs over the period 1986-1990 i.e. 96.9%. However the rate of increase has been decreasing every year

i.e. 32.8% in 1987, 23.7% in 1988, 18% in 1989 and 1.6% in 1990. This could be explained by the fact that the F&B revenue has not been increasing very much through the period, hence one should expect that the increase in the F&B cost will be at an even lower rate if the department is to make a profit.

Reviewing the Casino's costs, one can observe that they rose sharply in 1987 and 1988 by 44.8% and 31.7% and then they declined greatly in 1989 and 1990 by -2.9% and -3.4%.

Comparing the Casino's costs with the rate of change in the Casino's revenues, one will find that both followed the same trend. Analyzing the M.O.D. costs, one can recognize that they almost followed the same trend of the M.O.D. revenues for each separate activity i.e. Tel & Tlx, Laundry, Sports and Garage for the period 1986-1990.

#### **v. Departmental profit**

Throughout the next section, we will discuss the percentage breakdown of costs and revenues for every department in 1989. First it should be mentioned that the 17% service charge paid by hotel guests on each bill which represents a peculiar feature of the hotel industry in Egypt, will either be added to the departmental gross revenue or deducted from the departmental costs.

From Table (6.5), one can observe that the Rooms department salaries amounted to 2.7% of the Rooms revenue while the other expenses were 5.1% of the Rooms revenue. This resulted in a profit of 92.1% for the Rooms department, which exceeds the standard for five star hotels in Cairo i.e. 90%. The writer thinks that there is no room for improving the Rooms department



profit in terms of reducing costs, the only thing that could be done is to try to increase the occupancy rate and average room rate for Marriott.

From Table (6.6), it can be shown that the food revenue represented about 70% of the F&B departmental gross revenue, while the beverage revenue amounted only to 22.6%. This ratio is very much anticipated in five star hotels because the prices of liquors in Egypt are comparatively higher than abroad since hotels pay high import duties i.e. 300% on imported alcohols. Concerning the costs of the F&B department, it can be depicted that the salaries summed up to 31.2% of the F&B revenue while the other expenses were 13.2% of the F&B revenue. This have resulted in a F&B departmental profit of 43.3% which was higher than the standard for five star hotels in Cairo i.e. 39%. Nevertheless Marriott should try to increase the number of covers or turnover per table, which is the total restaurant revenue divided by the number of cheques. This could be achieved by enhancing the overall image of Marriott as a place where people can come and enjoy food, as the case of Sheraton Heliopolise, which was famous for its exquisite cuisine that attracted non guests as well as guests and led to a higher profit for its F&B department.

In Table (6.7) that examined the Casino's costs, one will detect that the major cost item was taxes that amounted to 49% of the Casino's revenues. By law, five star hotels have to pay a 50% tax on their Casino revenues to the state. The other main cost items were breakage costs, employee salaries and other expenses that represented 5.1%, 2.1% and 2% out of the Casino's

revenues. In short the Casino had a profit of 41.9% in 1989. The only item that can be reduced is the breakage cost which is rather high.

Moving to Table (6.8), we find that the primary cost item that was paid by Marriott to the Egyptian telecommunication for the costs of local and international calls, telexes and faxes was 51.2% of the Tel & Tlx revenues. The other cost components were minor i.e. salaries and other expenses which amounted successively to 1.4% and 2.1% of the Tel & Tlx revenues. Hence the Tel & Tlx department realized a departmental profit of 45.3% in 1989.

From Table (6.9), one can view that the Laundry & Dry Cleaning department had cost of sales that amounted to 26% of its revenues. The other incurred costs were minor ones i.e. salaries and other expenses that amounted to 1% and 1.2% of its revenue. This generated a high profit for the Laundry & Dry cleaning department i.e. 72% in 1989.

As for the Sports Centre, from Table (6.10) it can be regarded that the salaries amounted to 11.2% of the sports revenue whereas the other expenses were 15.6% of its revenues. This resulted in the Sports Centre having a profit of 73.1% in 1989. The last section in the M.O.D. was the Garage and from Table (6.11) one can spot that it had salaries that amounted to 12.3% of the Garage's revenues while the other expenses amounted to 3.4% of the Garage's revenues resulting in a net profit for the Garage of 84.2% in 1989.

Finally in Table (6.12), a detailed breakdown of the Rentals and Other income is given. It can be viewed that the Service



revenue produced the highest revenue i.e. 52% followed by the Shop rentals i.e. 23% and then interest on deposits which was 13%.

From the above mentioned analysis of the costs and revenues for the M.O.D., one can infer that there is little that can be realized to improve their overall high efficiency.

#### **vi. Overhead expenses**

Looking at the last section of Table (6.4), one can realize that most of the overhead expenses were in line with both the local and international standards for five star hotels. However Marriott had slightly higher energy costs and P.O.M.E.C. expenses than 5 star hotels abroad. This is however justified because energy costs in Egypt have been recently increased to comply with the IMF reform programme. As hotels earn foreign currency, the government already charges them higher energy costs. The only thing that can be accomplished by Marriott is that it maintains this 4% energy cost and does not exceed it in the future. On the other hand for the majority of five star hotels in Egypt, there is a written clause in the management contract between the owning company and the operator which requires P.O.M.E.C expenses to be equal to 4% of the hotel's revenue. P.O.M.E.C. is higher in Egypt than abroad by 1% because usually foreign operators want to make sure that the distinguished features of the five star hotels are maintained.

#### **vii. G.O.P.**

From Table (6.4), one can recognize that Marriott's G.O.P. has been increasing throughout the period 1986-1990, with the exception of 1990 where it was slightly reduced.

Having a G.O.P. of 53.4% reflects Marriott's high profitability, which surpasses that of five star hotels abroad. In conclusion, one can observe that on the whole Marriott's departmental profits were similar to the standard for five star hotels in Cairo. There were only few occasions when it was suggested that cost reductions should be incorporated in the future. Nevertheless the main modification that is strongly recommended is to increase Marriott's average room rate, which could be accomplished through more aggressive marketing efforts from management.

**viii. Similar assumptions that were used in the calculation of DCF for the three hotels:**

**1. Time span:** In forecasting future cash flows, the used time span was five years i.e. 1993-1997 to avoid the uncertainty involved in longer time spans.

**2. Future cash flows:** in forecasting the future cash flows, we inflated the prices of each component within the cash flows to arrive at the money cash flows which conforms with what Davis and Pointon (1984:45) mentioned: "each component cash flow inflated at its respective rate of inflation is termed money cash flow."

For each hotel, the specific price changes for each item in the operating statement was predicted for the coming five years. Finally the net money cash flows for each hotel was its expected G.O.P. less management fees. It should be pointed out that the fixed charges were not included because the buyer of the hotel is not expected to be burdened with the interest charges that was incurred by the government as confirmed by Hany (Interview, February 1992). If those charges were



included, the buyer would pay a lesser amount for the hotel. Also taxes were not incorporated because they are not included in the hotel accounts but in the owning company accounts.

**3. Discount rate:** Since there is no published figure in Egypt of inflation, the writer had to avoid predicting inflation by computing the discount rate through the use of the CAPM. In estimating the element of risk for any business, usually analysts could either make a downward adjustment to the expected stream of cash flows or increase the discount rate as mentioned by Pratt (1981). Further Ho and Pike (1991) pointed out that in general managers in the U.K. preferred to use simple risk adjustment methods i.e. raising the discount rate or the total project risk. The same procedure was employed in our estimation of risk for the three hotels. i.e. raising the discount rate for riskier hotels.

In order to calculate the discount rate,  $R_f$  was assumed to be equal to 18% which is the rate of return on treasury bills, beta of tourism was assumed to be 1.0, as explained in the previous chapter, and the risk premium for hotels varied between 3-5% depending on each hotel's perceived riskiness. Then a weighted average cost of capital was calculated based on a debt to equity ratio of 1.0. The used cost of debt was the prevailing rate of interest on tourist projects i.e. 20% and the tax rate used was 42%.

**4. Residual value:** In estimating the residual value, the G.O.P. of each hotel in 1997 was approximately chosen to be the normalized level of net cash flows that will continue indefinitely. This figure was then discounted by each hotel's

discount rate. It should be mentioned that the net operating profit of the hotel was not used. Instead we used roughly the G.O.P. figure because the net cash flows for each hotel were estimated for only five years which is a small time span, therefore one can safely assume that G.O.P. will still be increasing after the explicit period. Thus using an amount equal to the 1997 G.O.P. figure will not be an overestimation of the net cash flows that are expected to continue for the perpetual life of the hotels.

Finally in discounting we used the weighted average cost of capital and did not reduce from it the growth rate. This was due to two reasons. First the growth rate for each hotel cannot be easily predicted particularly because the writer does not know whether there will be future expansions or not. Also as several academics and practitioners have stated as time passes by, one should expect the present value growth opportunities of the company or its growth rate to be zero.

#### **5. Shortcomings in the coming analysis:**

According to Klaus (Interview, July 1992), the riskless rate of return used is not very accurate, since it is the return on short term treasury bills, whereas the correct one should be the return on government bonds. However in Egypt there is no active market in government bonds and their rate of return is very low.

Moreover Klaus (Interview, July 1992) remarked that the used market risk premium is very low i.e. 3-5%, since the one prevailing in developed markets reaches 8-9%. However this was in a way counteracted by having a high riskless rate of return



than that of developed markets.

Finally the writer did not interview management which of course would have provided her with more insight about their future expectations for each hotel, which in turn would have increased the accuracy of her valuation.

**ix. Assumptions for the calculation of Marriott's NPV**

1. The writer has made the cash flow projection for five years i.e. 1993-1997.

2. Average room rate was assumed to be L.E.375 in 1993 which is thought to be reasonable, taking into consideration, that Marriott will change its marketing strategy and place itself neck to neck with Intercontinental, by virtue of the distinctive features that it is endowed with, which we referred to earlier in this chapter.

Since the Intercontinental average room rate was about L.E. 224 in 1990, it is logical to start with L.E. 375 for Marriott in 1993. Furthermore, the Ministry of Tourism has announced in May 1992 that it will soon raise the rack rate for five star hotels Egypt since they were frozen during the 1991 season, because of the Gulf War.

Comparing the proposed average room rate for Marriott L.E. 375 or \$ 112, using May 1992 rate \$1 = 3.35 L.E., with the average room rates for five star hotels in London, one would realize that it is still very low. Parkinson (Interview, June 1992) stated that the average room rate for five star hotels in London was £150 in 1992. Furthermore in the magazine "Caterer and Hotelkeeper" dated 28/5/1992, it was stated that the 1991/92 tariff for Super Deluxe hotels in London was above £150

i.e. \$270 or more. Hence the average room rate for super five star hotel in London in 1992 is nearly 140% more than that of Marriott in 1993.

3. The increase in average room rate was assumed to be 20% annually. Several general managers of five star hotels have already informed the writer that the current annual increase in prices is 15%. Even with such an increase, Marriott room rate will be much cheaper than other five star hotels abroad. On the other hand Parkinson (Interview, June 1992) stated that the annual increase in the prices of five star hotels in the U.K. followed the inflation rate i.e. 10%.

In Egypt the government has declared that the inflation rate was 18% in 1992 after it has applied the economic reform programme, whereas the World Bank and AID mentioned that the inflation rate in Egypt was 25% or more. Taking a weighted average of the two figures, we will reach an inflation rate of 20%. Therefore our assumption that the average room rate will be increased by 20% annually, even if slightly higher than the 15% suggested by five star hotel managers in Egypt, is still sound.

4. Occupancy rates were assumed to be 75% for the first three years of projection and then 85% till the end of the period. The writer allowed Marriott more time to improve its marketing tactics so as to increase its occupancy rate to be 85% by 1996. We did not assume any higher occupancy rate to be on the safe side, despite the high expected future demand for tourism in Egypt compared to other tourist countries.

5. Projected breakdown of costs and revenues as a percent of



total revenue:

Revenues	
Rooms	41.5
F&B	26.0
Casino	19.0
Telephone & Telex	6.0
Laundry & Dry Cleaning	1.0
Sports	0.3
Garage	0.2
Rentals	6.0
	----
	100%
Costs	
Rooms	3.5
F&B	13.5
Casino	10.5
Telephone & Telex	3.0
Laundry & Dry Cleaning	0.2
Sports	0.1
Garage	0.1
	-----
	30.9%
Overhead expenses	
General & Administrative	3.0
Marketing	2.0
Insurance	0.2
Energy costs	4.0
P.O.M.E.C.	4.0
Other provisions	0.1
	-----
	13.3%
G.O.P.	55.9%
Management fees	17.0%
	-----
	38.9%

It should be mentioned that we made slight changes in the costs and revenues for Marriott, as we expected its management to make certain modifications before its sale to ensure a higher price. This led to a projected G.O.P. for Marriott equal to 55.9% which is slightly higher than its G.O.P. realized in 1989 i.e. 53.4%. In addition the current management fees paid by Egoth to Marriott i.e. 23% out of G.O.P. is very high if compared to fees paid to other operators in Egypt. Therefore we assumed that the management fee will be changed to 17% of

G.O.P. which will be still at the higher level.

#### 6. Discount Rate:

Hassanein (Interview, February 1992) mentioned that on average the risk premium for the overall stock market in Egypt would range between 3-5%, dependent on the risk of the company. He added that one could assume with confidence that the beta for the tourism industry is 1.0. The risk free rate on treasury bills was 19% in March 1992 but it was reduced to 18.5% in May 1992 and it became 18% in June 1992. Thus the writer used a risk free rate of 18%. For Marriott we assumed a risk premium of 3%.

Assuming debt/equity = 1.0

$R_f$  = 18% on treasury bills

$k_b$  = 20% (interest on tourist projects in June 1992)

$k_e = R_f + B_j [E(R_m) - R_f]$

$T$  = 42%

$B$  = 1.0 for the tourism sector

$[E(R_m) - R_f]$  = risk premium i.e. 3%

$E(R_m)$  = 21%

$k_b(1-T) = 20(1-0.42) = 11.6\%$

$k_e = R_f + B_j [E(R_m) - R_f] = 18 + 1.0(21-18) = 21\%$

**Weighted average cost of capital or discount rate K:**

$K = k_b(1-T) \times 0.5 + k_e \times 0.5 = 11.6 \times 0.5 + 21 \times 0.5 = 16.3\%$

**Hence we used a discount rate of 16.3% for Marriott.**

7. The residual value for Marriott was calculated by dividing L.E. 350 million by its discount rate i.e. 16.3%.

8. Marriott's value according to the various valuation methods:

Assuming the on going May 1992 exchange rate 1\$ = 3.35 L.E.

i. NPV = L.E. 1.65 billion or \$ 491 million as computed in Table (6.13).

ii. Room rate method: based on how much other five star hotels were sold. Parkinson (Interview, June 1992) suggested that for super hotels the cost per room was \$500,000. Applying this to Marriott's case:



**1147 x 500,000 = \$573 million or L.E. 1.9 billion.**

**iii. Capitalized earnings method:** since the discount rate used for Marriott was 16.3%, then its reciprocal or P/E would be about 6.13. The P/E or YP for Marriott is very low due to the higher interest rates in Egypt. To calculate its capitalized earnings we assumed that its expected earnings will be L.E. 350 million times the P/E i.e. 6.25 :

**350 million x 6.13 = L.E. 1.84 billion or \$ 549 million.**

**iv. Room Replacement method:** we assumed that the cost per room for Marriott would be \$700,000 which exceeds that of top five star hotels in London i.e. \$500,000 by virtue of its being a palace. Thus the room replacement value would be \$700,000 times the number of rooms i.e. 1147 which is equal:

**1147 x 700,000 = L.E. 2.7 billion or \$803 million.**

However one should be cautious when the replacement cost of Marriott is computed because it is a historical, listed building so the possibility of having the same building now is very remote which means that the calculated replacement cost is irrelevant.

Both Steel (Interview, May 1992) and Parkinson (Interview, June 1992) asserted that one cannot separate the intrinsic value of Marriott from its being a palace i.e. valuing the hotel as a mere palace would be like valuing a painting of Picasso or an antique which would depend on emotions not economics and in this case the hotel would be bought by a strategic buyer not a sophisticated investor. They confirmed that it would be absurd if a buyer bought the hotel and then sold it later as a property. On the other hand one cannot neglect the fact that

if the buyer sold the hotel as a property, he would have substantial gains, which is a possibility than cannot be ruled out. This has already occurred in the privatisation of Royal Ordnance that was sold to British Aerospace. According to the **Financial Times** dated 28/10/88, the Ministry of Defence was criticized because it did not carry out up-to-date property valuations before it sold Royal Ordnance to British Aerospace. As a result British Aerospace sold two sites in London as development land, and was able to realize up to £400 million on their sale, whereas it paid only £190 million for Royal Ordnance. To avoid the occurrence of such a thing to Marriott, the Egyptian government must be sure that the new buyers will not modify the hotel into anything else, which should be clearly stated in the clauses of the agreement between the buyers and the government.

#### **4. Cairo Sheraton Hotel**

##### **i. Description**

Sheraton International Group operates several hotels in Egypt, three in Cairo, one in Alexandria, one in Luxor and the last one in Hurghada by the Red Sea which was sold in 1991 through a private deal. The hotel that will be hereafter studied is Cairo Sheraton, the first hotel to be managed by Sheraton in Egypt. Cairo Sheraton has been operating since 1970 and in 1990 a new extension was added to the main building which increased Sheraton's capacity to become 660 rooms. It should be pointed out that Sheraton also overlooks the Nile but from a different place than Intercontinental, Marriott and Hilton. It is located in a busy but prestigious area less than



ten minutes by car from the city centre. An important thing to note is that Sheraton was previously favoured by Arab tourists, however they now prefer Intercontinental, Marriott and Hilton Ramsis.

#### **ii. Occupancy and Average Room Rates**

As performed earlier with Marriott, we will discuss the two main components that will affect Sheraton's profitability i.e. its occupancy and average room rates. From Table (6.14), one can view that Sheraton's occupancy rate increased highly by 17.3% in 1987 then at a lower rate in 1988 i.e. 4.3%. Following it was slightly decreased by 2.2% in 1989, whereas this decrease was augmented in 1990 due to the Gulf War to reach 12.8%.

Disregarding the 1990 figure, one can recognize that Sheraton's occupancy rate lied within the 80%-85% range, which was even better than the standard attained by five star hotels in Cairo. Also Sheraton's occupancy rate surpassed that of Marriott over the same period.

Coming to Sheraton's room rate, it will be noted that it has been increasing throughout the period i.e. 62.5%, 29%, 18% and 43.7% in 1987, 1988, 1989 and 1990 consecutively. Comparing Sheraton's room rate with that of Marriott, it could be seen that former's rate was much lower especially in 1988 and 1989 by 44% and 43% accordingly. The large increase in Sheraton's room rate over the period should not misguide the reader, because Sheraton started with a very low room rate i.e. L.E. 48 in 1986. This might imply that Sheraton's management used this low rate policy to secure a higher occupancy rate.

Nevertheless one can realize that management's approach has changed towards the end of the period, in particular in 1990 where we find that Sheraton's rate was only 10% lower than that of Marriott. Though Sheraton's higher rate might have caused its occupancy rate to drop to 73.1%, one cannot neglect the adverse effect of the Gulf War, besides what we have referred to before that Arab tourists now prefer to stay in other hotels.

Finally in order to maintain a competitive position in relation to other five star hotels in Egypt, Sheraton have to always review its prices upward. Nevertheless one can expect Sheraton to be able to retain its 80% occupancy rate, bearing in mind the future expected increase in tourists to Egypt.

#### **iii. Departmental revenues as a % of total revenue**

Table (6.15) gives us the operating statements for Sheraton through the period 1986-1990. From Table (6.16), it can be viewed that Sheraton's Rentals revenue has undergone an enormous increase of 871.2% over this period. This is mainly due to the opening of its new extension in 1990. Then came the Rooms revenue whose overall change in this period was 473.3%. The F&B revenue ranked third with an overall increase of 124.3% and at last came the Casino revenues that increased only by 28.1%.

From Table (6.17), it can be observed that the Rooms revenue represented 41% of the total revenue in 1989 which however rose to 45.4% in 1990. As we mentioned earlier, our principal year for analysis will be 1989 because 1990 was an unusual year for the tourism industry. Having Rooms revenue that amounts to 41%



of the hotel's revenue places Sheraton at a lower position when compared to the standard for five star hotels in Cairo which was 50%. Reviewing Sheraton's F&B revenue, one will find out that it amounted to 33% of the hotel's revenues which was somewhat lower than the standard for five star hotels in Cairo i.e. 37%.

Sheraton however was able to make it up through its Casino revenue that amounted to 19.3% of its total revenue. Looking at the M.O.D. revenue, which included the Tel & Tlx revenue as well as the Other income, one can note that it amounted to 5.3% of total revenues which was lower than the standard for five star hotels in Cairo i.e. 8%. Finally the Rentals revenue amounted to 1.2% of Sheraton's revenues in 1989 but was greatly raised in 1990 to reach 4.7% of its revenues, due to the opening of the new extension.

It should be pointed out that in our cash flow projection for Sheraton, both 1989 and 1990 will be taken into consideration because 1990 was special for Sheraton in terms of the opening of its new extension, which had a positive effect on its G.O.P. that rose from 32.7% in 1989 to 44.7% in 1990, despite the drop in its occupancy rate due to the Gulf War.

#### **iv. Departmental costs**

From Table (6.16) we can realize that both the Rooms and F&B departmental costs have been increasing throughout the period 1986-1990 at 177.3% and 139.9% accordingly. Inspecting those figures in detail, one can note that the Rooms department cost was increased in 1987 by 15.1% then the rate of increase was decreased to 11.6% in 1988. Then it has undergone sharp

increases in 1989 and 1990 by 45.6% and 48.2% subsequently. If one reviewed the Rooms department revenue, it can be shown that it was sharply increased in 1987, 1989 and 1990 which was reflected in the above mentioned increase in costs. This is quite plausible because one would usually expect to see the direct costs for each department follow the department's revenue but at a lower rate.

As for the F&B department, its costs were highly increased in 1987 by 39.7%, then the rate of increase was slower in 1988 i.e. 13.5%. Then it once more mounted by 26.8% in 1989 and afterwards the rate of increase was reduced by 19.4% in 1990. As remarked before, the change in the F&B department costs followed the same direction as its revenues.

Looking at the Casino costs, one can regard that they were reduced by 6.7% in 1987, then they were slightly increased by 3.9% in 1988, afterwards they were reduced by 13% in 1989 and finally they were increased by 18.1% in 1990. Also one can see that the Casino costs followed the same trend as its revenues. As for the M.O.D. one can note that for the period 1986-1988 they were lumped under other income revenue, whereas for the last two years i.e. 1989 & 1990, the Tel & Tlx costs were shown as a separate item in Sheraton's accounts. Thus to arrive at the total M.O.D. costs, the Tel & Tlx costs were added to the other cost items. Hence it can be shown that the M.O.D. costs rose by 18.4% in 1987, then they were slightly reduced in 1988 by 4.6%. In 1989 the decline was at a higher rate i.e. 82.8% and then once more the costs rose sharply in 1990 by 66.2%.



#### **v. Departmental profit**

In order to assess Sheraton's efficiency and overall performance, the breakdown of costs and revenues for each department, need to be examined. Table (6.18) showed that for the Rooms department, the salaries amounted to 4.9% of its revenue, while other expenses represented 8.2% of the Rooms revenue. Thus the Rooms department had total costs of 13% that resulted in a departmental profit of 87%. It should be remarked that Sheraton's Rooms profit was lower than the standard for five star hotels in Cairo i.e. 90%. and also that of Marriott i.e. 92%. Comparing Sheraton to Marriott, taking into consideration that Marriott's number of rooms was 70% more than Sheraton, it can be depicted that Marriott's management were more efficient in their cost control. This represents an area that Sheraton's management should try to improve in the future, in specific, the high salaries as well as the high costs of guest supplies and laundry.

Analyzing the F&B department costs in Table (6.19), one can notice that the direct cost of F&B amounted to 37% of the F&B revenue, whereas salaries and other expenses represented 19% and 22.7% out of the department's revenue. This led the F&B department to have a profit that amounted to 21.4%. Hence the F&B department profit was nearly 82% lower than the standard for five star hotels i.e. 39% and it was 102% lower than Marriott's F&B profit which was 43.3%.

Comparing Tables (6.6) and (6.19), one can discover that Sheraton direct costs i.e. 37% were higher than Marriott i.e. 31%, however the main discrepancy was due to the higher

salaries and other expenses costs which were 41.7% for Sheraton and only 25.6% for Marriott.

From Table (6.20) it can be observed that Sheraton's Casino profit represented 36% of its revenues while that of Marriott was 41% i.e. Table (6.7). This was mainly due to Sheraton's higher salaries cost i.e. 10.3% of the Casino's revenues as opposed to Marriott's 2.1%.

From table (6.21) it can be shown that Sheraton's Tel & Tlx profit as a percent of the department's revenue was very low in 1989 i.e. 11.8% but it improved to 24.4% in 1990. Even with this profit rise, the Tel & Tlx profit still earned lower profit than that of Marriott i.e. 45%. This was because Sheraton had a higher cost of sales which was 83% in 1989 versus 51.2% for Marriott in the same year. This is rather strange because the cost of calls, facsimiles and telexes should be fairly the same for Cairo hotels since one expects them to be charged the same fare from the Egyptian Telecommunications Authority. This also suggests an area that Sheraton can improve in the future.

From Table (6.22) it can be viewed that Sheraton's M.O.D. profit depended primarily on the Laundry & Dry cleaning. The Laundry & Dry Cleaning department's profit as a percent of the M.O.D. revenue was 43% in 1989 and increased sharply to 63.6% in 1990. Still it was much lower than that of Marriott which amounted to 72% and 77% out of its departmental revenues in 1989 and 1990 consecutively.

Comparing Table (6.9) for Marriott and Table (6.22) for Sheraton, one can detect that the salaries item amounted to



27.4% and 1% of the M.O.D. revenues for both Sheraton and Marriott.

Finally concerning the Rentals & other income, in Table (6.23) it can be viewed that Sheraton's major source of revenue was shop rentals that amounted to 92% out of Rentals & other income in 1989.

#### **vi. Overhead expenses**

Reviewing the overhead expenses incurred by Sheraton in Table (6.17), one can find that in general they complied with the standard for five star hotels in Egypt. The variances however has been in the Administrative & General expenses that were high for Sheraton in 1989 i.e. 5.2% but they were reduced to 4.5% in 1990. Second the marketing expenses were 3% of total revenue which is higher than the 2% standard incurred by other five star hotels in Cairo. Thus Sheraton should try to reduce those two expenses to conform with the standard for five star hotels in Cairo. As for the other overhead costs, the only thing that can be done is to maintain their current levels.

#### **vii. G.O.P.**

After analyzing the various elements of costs and revenues for Sheraton, one can say that Sheraton could make several changes to enhance its overall profitability. First management should implement a cost savings plan in order to reduce its high costs. Though Sheraton's G.O.P. has increased from 32.7% to 44.7% in 1990 i.e. 37% rise in one year, it is below the 50% standard for five star hotels in Cairo, bearing in mind that there are several five star hotels in Egypt that surpassed this 50% G.O.P. such as Intercontinental, Marriott,

Nile Hilton, Movenpick Luxor etc.. Furthermore Sheraton has got a Casino which if managed better as was the case in Marriott hotel would yield higher profits to the hotel. In addition it was clearly observed that some of Sheraton's departments had high salaries which was a cost burden that resulted in lower departmental profits. The main reason for that was the higher number of employees utilized by Sheraton. To clarify this point, the Cairo Hotel Association 1990 Records, stated that the staff room ratio was 1.9 for Sheraton. On the contrary, other five star hotels in Cairo had a much lower staff room ratio: for example Intercontinental was 1.5, Marriott was 1.1 and Hilton Ramsis was 1.2. Therefore if Sheraton is to be privatised, its employee force should be reduced since the present number is high when compared to five star hotels in Egypt and abroad and it has certainly lowered its overall efficiency.

The last point to comment on is about the average room rate for Sheraton which was L.E. 171 in 1990. Basically it is very low if compared with the major five star hotels in Cairo. From the Cairo Hotel Association 1990 Records, one can observe that Sheraton ranked penultimate in terms of the average room rate when compared to other thirteen five star hotel in Cairo. Therefore Sheraton's management should raise its average room rate. As stated before management have already amended the room rate in 1990 due to the opening of the new annex, nevertheless further increase is still required. Even with the higher prices, Sheraton can secure an occupancy rate of 80%.



**viii. Assumptions for the calculation of Sheraton's NPV**

1. Cash flow projection was done for five years same as Marriott i.e. 1993-1997.
2. Average room rate is assumed to be L.E. 275 in 1993 which is much lower than that of Marriott since the latter is placed at the top end of the five hotel stars in Cairo.
3. The annual increase in prices was assumed to be 20% which was consistent with Marriott.
4. An Occupancy rate of 80% was assumed for the whole period which is fairly conservative.
5. Projected breakdown of costs and revenues as a percent of total revenue:

Revenues

Rooms	44.0
F&B	28.0
Casino	17.0
Telephone & Telex	5.0
M.O.D.	1.0
Rentals	5.0
	----
	100%

Costs

Rooms	4.5
F&B	15.0
Casino	9.0
Telephone & Telex	3.0
M.O.D.	0.5
	-----
	32.0%

Overhead expenses

General & Administrative	5.0
Marketing	2.0
Insurance	4.0
Energy costs	3.0
P.O.M.E.C.	4.0
	-----
	18.0%

G.O.P.	50.0%
Management fees	16.0%
	-----
	34.0%

The above mentioned projected costs and revenues led to a

projected G.O.P. of 51% for Sheraton which is higher than its achieved one in 1990 i.e. 44.7%. However this was based on the modifications that Sheraton have to undertake to reach this G.O.P. Furthermore the forecasted G.O.P. for Sheraton conforms with the standard for other five star hotels in Egypt.

#### 6. Discount Rate:

The proposed risk premium for Sheraton was assumed to be 5% which is higher than the one we used for Marriott.

Assuming debt/equity = 1.0  
 $R_f = 18\%$  on treasury bills  
 $k_b = 20\%$  (interest on tourist projects in May 1992)  
 $k_e = R_f + B_j [E(R_m) - R_f]$   
 $T = 42\%$   
 $B = 1.0$  for the tourism sector  
 $[E(R_m) - R_f] = \text{risk premium i.e. } 5\%$   
 $E(R_m) = 23\%$   
 $k_b(1-T) = 20(1-0.42) = 11.6\%$   
 $k_e = R_f + B_j [E(R_m) - R_f] = 18 + 1.0(23-18) = 23\%$   
**Weighted average cost of capital or discount rate K:**  
 $K = k_b(1-T) \times 0.5 + k_e \times 0.5 = 11.6 \times 0.5 + 23 \times 0.5 = 17.3\%$   
**Thus the discount rate for Sheraton will be 17.3%**

7. The residual value for Sheraton was L.E. 124 million divided by its discount rate i.e. 17.3%.

8. Sheraton's value according to the various valuation methods:

Assuming the on going May 1992 exchange rate 1\$ = 3.35 L.E.

i. NPV = L.E. 549 million or \$ 164 million as computed in Table (6.24).

ii. Room rate method: based on how much other five star hotels were sold. Assuming that the price per room is equal to \$250,000:

$660 \times 250,000 = \$ 165 \text{ million or L.E. } 553 \text{ million.}$

iii. Capitalized earnings method: since the discount rate used for Sheraton was 17.3%, then its reciprocal or P/E would be about 5.78. To calculate its capitalized earnings we assumed



that its expected earnings will be those earned in 1997 i.e. L.E. 124 million times the P/E or 5.78:

**124 million x 5.78 = L.E. 717 million or \$ 214 million.**

**iv. Room Replacement method:** we assumed that the cost per room for Sheraton would be \$300,000.

**660 x 300,000 = \$ 198 million or L.E. 591 million.**

## **5. Aswan Oberoi Hotel**

### **i. Description**

Aswan, placed at Upper Egypt is far from Cairo approximately one hour by plane. It is a small city that commands a very picturesque view of the Nile. It is famous for: Philae temple, the Elephantine Island, the High Dam, the Unfinished Oblesik, the botanical gardens and the Aga Khan tomb.

Aswan Oberoi is managed by the international Indian chain Oberoi that operates hotels worldwide. It currently manages three hotels in Egypt. The most famous one is Mena House Oberoi in Cairo which commands a unique view of the Pyramids. The second one is Oberoi El Arish which is situated in El Arish city that lies on the Red Sea coast and is well known for its beautiful beaches where palm trees are grown. Finally Aswan Oberoi which is our main concern, is one of the few five star hotels in Aswan. It is built on an island in the Nile, which gives the hotel a very scenic ambience. Aswan Oberoi has 160 rooms and it started operation since 1972.

### **ii. Occupancy and Average Room Rates**

It should be indicated that the hotels in Aswan have high seasonality in demand due to the weather which is very hot

in Upper Egypt at summer and reaches 45° C. Thus one would find that the high season for hotels in Upper Egypt i.e. Luxor and Aswan, will be from October through April, whereas May till September will constitute their off season. However as we stated in the previous chapter, due to the large discounts offered by hotels to group tourists during summer, the high seasonality is curbed. According to the Egyptian Tourist Authority, the occupancy rate for five star hotels in Aswan in the period 1987-1989 was 63%, 75.5% and 66% accordingly. On the other hand, on inspecting Oberoi's occupancy rate in Table (6.25) over the period 1986-1990, one can clearly observe that it had a gigantic increase in 1987 which amounted to 70%. Subsequently the rate of increase in Oberoi's occupancy rate slowed down to be 7.2% in 1988 and then it increased by 3.3% in 1989 and finally it was reduced by 18.5% in 1990 due to the Gulf War. From the above, it can be depicted that Oberoi's occupancy rate was higher than the standard for five star hotels in Aswan throughout the period. In particular it had an enormous increase in 1987, which was also encountered in terms of Marriott and Sheraton, because 1987 has featured a phenomenal increase in tourists and tourist nights to Egypt. Oberoi's occupancy rate exceeded 75% in 1988 and 1989 which is remarkably high, given the seasonality of demand as well as the occupancy rate of comparable five star hotels. As one can foresee, its occupancy rate was severely reduced in 1990 due to the Gulf War, which unfortunately occurred during its peak season. This is because the majority of tourists that visit Upper Egypt are westerners who were afraid to travel to the



Middle East at that time.

Studying Oberoi's average room rate, one can perceive that it has been continuously increasing throughout the period. The rate of increase was 33.7% in 1987, 62.8% in 1988, 41.5% in 1989 and 9.3% in 1990. Further it can be observed that Oberoi was not confined to a given increase in prices and in most years the rate of increase exceeded 30%. In addition it is clear that Oberoi started with a very low average room rate, however it succeeded in charging higher prices towards the end of the period i.e. 1988 and 1989, with the exclusion of 1990 since it was an exceptional season for Upper Egypt.

**iii. Departmental revenues as a % of total revenue**

Table (6.26) gives us the operating statements for Oberoi over the period 1986-1990. It should be pointed out that Oberoi's accounts did not have a breakdown of each department's direct cost, instead all departmental direct costs were summed up. Nevertheless one can evaluate the efficiency of each department from the tables that calculated the departmental profits.

From Table (6.27), one can realize that all the departments have undergone a substantial increase in their revenues.

In particular, the Rentals and Other income achieved an astronomical increase that amounted to 1460.2% over the period 1986-1990. Of course the reader should not be misled by this increase. From Table (6.28), it can be viewed that Rentals revenue was basically very low i.e. 1.3% of Oberoi's revenues in 1986 which has risen to 5.3% in 1990. Concerning the overall increase over the period for the other departments, one can

observe that the Rooms department ranked second i.e. 372.4% followed by F&B department i.e. 103.4% and finally came the M.O.D. i.e. 73.5%.

Looking at Table (6.28), one can depict that the Rooms department revenue amounted to 53.7% of Oberoi's revenue in 1989 which exceeded the standard for five star hotels in Egypt that was 50%. Of course this is a good indicator for the overall efficiency of any hotel because the higher the Rooms revenue, the higher its G.O.P., given that its Rooms costs are kept within control.

Concerning the F&B departmental revenue, it amounted to about 39.6% of the hotel's revenue which was also higher than the standard for five star hotels in Egypt which was 37%.

As one can observe, the Tel & Tlx revenue was separated from the other M.O.D. revenues in Oberoi's accounts. However if we added the Tel & Tlx revenue to the other M.O.D. revenue, we will find that the M.O.D. revenue amounted to 3.8% of the hotel's revenues in 1989 which is 52.5% lower than the standard for five hotels in Egypt i.e. 8%.

Finally the Rentals and Other income summed up to 2.9% of Oberoi's revenues in 1989 and then it increased to reach 5.3% of the hotel's revenues in 1990, which exceeded the standard for five star hotels in Egypt i.e. 4%.

From the above ratios, one can conclude that the majority of Oberoi's revenues came from two departments i.e. Rooms and F&B departments, whose revenues represented 93.3% of Oberoi's revenues in 1989.



#### **iv. Departmental costs**

Studying the change in the direct operating costs for Oberoi throughout the period 1986-1990, one can discover that management was able to reduce the costs despite the increase in overall revenues. In other words the operating costs as a percent of the hotel's revenues were reduced from 54.6% in 1986 to 31.5% in 1989 which is a great achievement by its management which was reflected in the notable increase of its G.O.P. from 17.3% in 1986 to 45.3% in 1989. Nevertheless there is still plenty of room to improve Oberoi's performance in order to achieve the standard G.O.P. of 50%.

#### **v. Departmental profits**

From Tables (6.28) and (6.29), one can observe that though Oberoi had a high Rooms revenue that amounted to 53.7% of the hotel's revenues, its Rooms profit was only 85.9% of the department's revenues in 1989, which was lower than the standard for five star hotels in Egypt i.e. 90%. This was because the Rooms department costs were rather high i.e. 14.1% which were divided into salaries i.e. 6.3% and other expenses i.e. 7.8%. Both expenses were remarkably high if compared to Marriott's costs in 1989, despite the fact that Marriott had more rooms.

Reviewing Oberoi's F&B revenue in Table (6.30), one can realize that the department has succeeded in achieving a profit of 45.5% in 1989 which surpassed the standard for five star hotels in Egypt i.e. 39%. The reason behind this high departmental profit is its lower F&B cost of sales i.e. 31.6%, lower salaries i.e. 14% and lower other expenses i.e. 8.9%.

Having lower F&B costs as well as lower salaries is expected in Upper Egypt since the price of food would be at least 30% lower than that of Cairo and of course the pay rate is lower than Cairo.

From Table (6.31) it can be seen that the Tel & Tlx department had incurred very high costs, in particular, its cost of sales amounted to 80.7% of the department's revenues in 1989. This greatly reduced Oberoi's Tel & Tlx departmental profit which was only 17.1%, which was inferior to that achieved by Marriott and Sheraton. One reason that can partially justify those high costs is that Aswan is far away from Cairo and therefore Egyptian Telecommunications Authority would charge Oberoi higher fares, particularly for the long international calls. If this was the only reason, Oberoi can resolve it by charging the guests a higher rate, taking into account the rates charged by other five star hotels in Upper Egypt. For example Movenpick Luxor charges its guests after thirty seconds from their dialling whether there was an answer or not to their call.

Further one can suggest that management investigates this problem carefully to try to cut down the high direct costs of its Tel & Tlx department.

Table (6.32) showed that the Laundry department had a profit of 83.1% which is quite high due to its lower cost of sales that amounted to 16.9% of its departmental revenues. As one can note that Oberoi's Laundry profit was higher than that of Marriott and Sheraton in 1989.

In Table (6.33) one can see that Oberoi had a separate outlet i.e. Cigarette section which sold cigarettes to its guests. The



Cigarette's section had a profit of 43% out of the total revenue.

Table (6.34) displayed the breakdown of Oberoi's Health Centre costs. It can be noted that the Health Centre's salaries and other expenses amounted to 10.6% and 5.2% out of the health centre's revenues. This made Oberoi's health centre gain a profit of 84.2% in 1989 which surpassed that of Marriott for the same year.

Finally reviewing Oberoi's Rentals and Other Income in 1989 in Table (6.35), one can observe that it was mainly income from shop rentals.

#### **vi. Overhead costs**

From Tables (6.27) and (6.28), one can view that Oberoi's overhead or undistributed expenses has been increasing over the period. In detail, the Administrative expenses amounted to 4.8% of the hotel's revenues in 1989 and nearly doubled in 1990 to reach 9.5% which is a very alarming figure. Already the 4.8% Administrative expenses of 1989 is high if compared with the standard of five star hotels in Cairo which was only 3%. Marketing expenses amounted to 2.2% of total revenue which is somewhat higher than the standard for five star hotels in Cairo which was 2%. Energy costs amounted to 2.4% in 1989 which was the only overhead expense that was lower than the standard for five star hotels in Cairo i.e. 4%. On the contrary P.O.M.E.C. and Replacement costs were very high i.e. 7.1% and 6.7% out of the hotel's revenue in 1989 as opposed to 4% which is the standard cost for both items in five stars hotels in Cairo.

From the above it can be viewed that the main reason behind Oberoi's lower G.O.P. was its high overhead costs. In particular the administrative, P.O.M.E.C. and replacement costs were very high when compared to its competitors locally or internationally. One of the reasons might be higher salaries paid to management or Oberoi might have installed new machinery or equipment that resulted in those high overhead expenses. The only thing that can be suggested is that Oberoi's management should work hard to reduce those fixed costs which will undoubtedly improve the hotel's G.O.P. in the future.

#### **vii. G.O.P.**

From Table (6.28), one can visualize that Oberoi's G.O.P. increased by about 162% from 1986 to 1989 which is quite impressive. However Oberoi's G.O.P. i.e. 45.3% in 1989, is still lower than five star hotels in Egypt i.e. 50% and lower than that of Movenpick Luxor which sometimes reaches 60%, given that the two hotels are in Upper Egypt and exposed to similar overall circumstances.

As we mentioned in the above section, though Oberoi's management succeeded in reducing their operating costs over the last two years, their overhead expenses were too high if compared to five star hotels. This necessitates that Oberoi's management explores the reasons behind those high costs and undertakes the right actions to reduce them. If this problem is solved, one can be sure that Oberoi will be able to attain a higher G.O.P. because already its occupancy and average room rates are sound when compared to other competitors in Aswan.

#### **viii. Assumptions for the calculation of Oberoi's NPV**



1. Cash flow projection was done for five years same as Marriott and Sheraton i.e. 1993-1997.
2. Average room rate is assumed to be L.E. 250 in 1993 which is consistent with Oberoi's previous increases in the past period.
3. The annual increase in room prices was assumed to be 25%, which is higher than that used for the other two hotels in Cairo because Oberoi has previously increased its room rate by 30%. Also one can expect hotels in Upper Egypt to have a higher increase in the room rate than those of Cairo by virtue of the higher demand on them particularly during their peak period.
4. An Occupancy rate of 75% was assumed for the first two years and then Oberoi was assumed to reach 80% afterwards.
5. Projected breakdown of costs and revenues as a percent of total revenue:

Revenues	
Rooms	53.5
F&B	38.0
Telephone & Telex	2.5
M.O.D.	1.0
Rentals	5.0
	-----
	100%
Operating costs	31%
Overhead expenses	
General & Administrative	5.0
Marketing	2.0
Energy costs	3.5
P.O.M.E.C.	4.0
Replacement provision	4.0
	-----
	18.5%
G.O.P.	50.5%
Management fees	16.0%
	-----
	34.5%

6. Discount Rate:

An assumption was made that the risk premium for Oberoi

would be 6.0 which is slightly higher than that of the total market. This is because of the higher risk attached to its returns in case of unexpected events such as the Gulf War. In other words in unfavourable circumstances we expect that the risk will be higher for Oberoi.

$R_f = 18\%$  on treasury bills  
 $k_b = 20\%$  (interest on tourist projects)  
 $k_e = R_f + B_j [E(R_m) - R_f]$   
 $T = 42\%$   
 $B = 1.0$  for the tourism sector  
 $[E(R_m) - R_f] = \text{risk premium i.e. } 6\%$   
 $E(R_m) = 24\%$   
 $k_b(1-T) = 20(1-0.42) = 11.6\%$   
 $k_e = R_f + B_j [E(R_m) - R_f] = 18 + 1.0(24-18) = 24\%$   
**Weighted average cost of capital or discount rate K:**  
 $K = k_b(1-T) \times 0.5 + k_e \times 0.5 = 11.6 \times 0.5 + 24 \times 0.5 = 17.8\%$   
**Hence the discount rate used for Oberoi was 17.8%**

7. The residual value for Oberoi was L.E. 26 million divided by its discount rate i.e. 17.8%.

8. Oberoi's value according to the various valuation methods:

Assuming the on going May 1992 exchange rate 1\$ = 3.35 L.E.

i. NPV = L.E. 108 million or \$ 32 million as computed in Table (6.36).

ii. Room rate method: based on how much other five star hotels were sold. Assuming that the price per room is equal to \$200,000:

$160 \times 200,000 = \$ 32 \text{ million or L.E. } 107 \text{ million.}$

iii. Capitalized earnings method: since the discount rate used for Oberoi was 17.8%, then its reciprocal or P/E would be about 5.62. To calculate its capitalized earnings we assumed that its expected earnings will be approximately L.E. 27 million times the P/E or 5.9:

$27 \text{ million} \times 5.62 = \text{L.E. } 152 \text{ million or } \$ 45 \text{ million.}$

iv. Room Replacement method: we assumed that the cost per



room for Oberoi would be \$200,000.

$$160 \times 200,000 = \$ 32 \text{ million or L.E. } 107 \text{ million.}$$

#### 6. Sensitivity Analysis:

One can observe that the NPV of each hotel was calculated based on some assumptions concerning its cash flows, discount rate, riskless return etc.. However as we remarked previously, the NPV's main shortcoming is its dependence on the analyst's estimates. Hence one expects the value of the hotel to change if the used assumptions were changed. To examine what will happen to the value of the hotels under study if we changed some of the used variables, a sensitivity analysis was effected. In this exercise five variables were changed i.e. market risk premium, beta for tourism, riskless return, average room rate and occupancy rates for the last two years. Then the value of each hotel was calculated changing only one variable at a time. This can be depicted in Tables (6.37), (6.38) and (6.39) for Marriott, Sheraton and Oberoi respectively.

From those three tables, one can recognize that the changes in the NPV of the hotels were relatively more affected by the changes in the average room rate and the riskless rate of return. Further it should be pointed out that because the riskless return is quite high in Egypt, one should expect it to be lowered by the government in the future, which will result in higher values for hotels. Second the average room rate which is an important factor in determining hotels' profitability, is lower in Egypt than abroad and therefore there exists ample room for increasing it in the future, which will augment the hotels' values.

#### D. Conclusion:

In this chapter we determined a value range for three five star hotels in Egypt i.e. Cairo Marriott, Cairo Sheraton and Aswan Oberoi using four valuation methods. Though the NPV method is preferred by most analysts and consultants, the final value of each hotel will be determined by the market itself i.e. negotiations between the buyers and sellers.

In the next two tables, the main issues concerning valuation of hotels as well as the valuation range for the three five star hotels will be summarized.

#### **First Table:**

<u>5 star Hotels in Egypt</u>	<u>Main Issues encountered</u>
Occupancy rate	Major determinant factor in a hotel's profitability.
Average Room Rate	Another determinant factor in a hotel's profitability. The higher the average room rate, the higher the NPV.
Departmental Profits	Rooms department has the highest profit, followed by F&B department and then M.O.D. Usually the higher the Rooms profit, the higher the profitability of the hotel.
Overhead Expenses	Include energy cost, administrative cost, P.O.M.E.C. The lower the overhead cost, the higher the hotel's G.O.P.
G.O.P.	High for five star hotels in Egypt so one can assume 50% or more with confidence.
Valuation of hotels	Several methods are used to provide a cross check for valuers. There is no one right method, but the most favoured one is the NPV.



Cash flows	Predicted only for five years to avoid uncertainty of forecasts.
Residual Value	Constitutes the bulk of the cash flows. In our analysis we divided last year G.O.P. by the cost of capital and ignored the growth rate.
Riskless rate	18% on treasury bills
Cost of Debt	22% on tourism projects
Risk Premium	3-6% for tourism projects
Beta of tourism	1.00. Assume tourism risk same as the market risk.
Capital Structure	Assuming Debt 50% and Equity 50%
Cost of capital	Based upon the above assumptions For our valuation exercise, the used cost of capital was relatively high due to the high discount rate used.

## Second Table:

L.E. million

<u>Valuation Method/Hotel</u>	<u>Marriott</u>	<u>Sheraton</u>	<u>Oberoi</u>
NPV	1,650	549	108
Room Rate	1,900	553	107
Capitalized Earnings	1,840	717	152
Room Replacement	2,700	591	107
Average	2,022	602	118
Standard Deviation	402	68	19

- More emphasis is placed by valuers and academics on the NPV method.

- Marriott had the largest standard deviation because of its relatively high room replacement cost since it is a palace.

- The valuation range was not very wide for the three hotels which in a way reflects the reasonableness of the valuation.

- As mentioned before since the used riskless return is high and the average room rate for hotels in Egypt is low if compared to abroad, one can presume that the valuation conducted for these three five star hotels is rather conservative.

### Notes and References:

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- Interview with General Manager of Luxor Movenpick, Egypt, January 1992.
- Interview (telephone) with Klaus, J. Corporate Finance Department, Coopers & Lybrand, London, July 1992.
- Interview with Hassanein, M. Chairman of Aricon Co. and Professor at the American University, February 1992.



## **Chapter 7     Technical analysis of Cairo Stock Exchange and the construction of indexes.**

### **A. Introduction:**

The chapter will first discuss the important role played by the securities market in any economy. Next an overview of the various stages that the Egyptian Stock Exchanges have passed through over the last sixty years will be given. Since little is known about the technical efficiency, effectiveness or absorptive capacity of the Egyptian stock market, the chapter will therefore report the first stock price indices to be constructed for contemporary Egyptian markets i.e. Cairo All Share Index and the Tourism Index. Then the chapter will conduct some technical exercises to examine the volatility of changes in both indexes, effect of events on the movement of both indexes and whether there was any correlation between the two indexes. Next considerable use was made of Datastream to explore the relationship between Cairo All Share Index and other capital market indexes. Further an examination was carried on the relationship between the 'Tourism Index' in Egypt and the 'Hotels and Catering Index' of other developed countries. Finally we compared Cairo Stock Exchange to other thirty emerging markets in terms of the number of listed companies, market capitalization, value traded and turnover ratio. The chapter concludes by pointing out that trading on Cairo Stock Exchange displayed the characteristics of a thin and inefficient market. This was confirmed when it was compared to other capital markets. However the Tourism Index was

moderately correlated with the hotel indexes of other developed markets.

**B. The role of the securities market in the economy:**

To be able to answer the question of whether the stock market has a favourable effect on the economy or not, it should be pointed out that the mere provision of financial institutions and of opportunities for acquiring financial assets will not per se raise the rate of savings in an economy. However there are some grounds for expecting savings to respond positively to financial development.

First the provision of financial assets divorces individual acts of savings from acts of investment over both time and place and an equity market extends the set of assets available for investors. Next the yield anticipated on security ownership may be sufficiently great to attract net savings of income that would otherwise have been consumed. Also net savings may occur because of other attractive features of securities ownership i.e. possibility of capital gains or the protection of savings against inflation as stated by Drake (1980).

In addition to the savings function provided by the securities market, local financial development will discourage capital outflow by providing attractive financial assets especially negotiable securities in the home country.

Further Bradley and Teweles (1987) mentioned that stock exchanges provide accurate and continuous reports on sales and quotations of securities superior to those of any other type of market.

In addition Bradley and Teweles (1987) remarked that one of the



most important functions of stock exchanges is the creation of a continuous market. They explained that in a continuous market, securities are bought and sold in volume with little variance in current market prices. Hence having a continuous market will create marketable, liquid investments that can be redeemed easily and quickly. Further they remarked that listed securities are usually good collateral for loans i.e. they have a higher collateral value for borrowers and at the same time lenders have behind the loan a liquid security that could be quickly sold if the loan was jeopardized.

Moreover the securities market will increase the economic efficiency by allocating capital more efficiently by establishing fair prices for securities and by minimizing the costs of buying and selling them. Thus it enables institutional investors to adjust their portfolios quickly without having to hold large cash balances.

Also Oyhenart (1991) stated that equity markets will stimulate efficiency in the financial system by offering alternative and competitive instruments. She added that they will encourage democracy of ownership and income distribution by offering the public at large the opportunity to share in corporate profit. Finally the existence of a securities market makes the country's financial system and economy more stable. The significance of equity capital is that it provides permanent finance with no contractual payments i.e. risk capital. By contrast, nonnegotiable bank type debt finance is fixed term and with floating rates of interest, carries contractual interest payments whose size is hard to predict. Thus Gill and

Tropper (1988) remarked that the recent heavy dependence on short and medium term bank loans to finance development and B/P deficits led to the debt crisis faced by several developing countries in 1982. On the other hand, it was argued that the presence of a strong securities market and greater reliance on equity finance would have reduced a lot of these problems by making borrowers less vulnerable to high real interest rates.

From the above one can realize the vital role that is played by securities market in the economy.

Applying this to the Egyptian case, Abdel Wahab (Gaballah, 1992) from the Prime Minister's Cabinet, asserted that the government thinks that now is the most appropriate time for the stock market in Egypt to assume an important role. This is because the Egyptian government has already embarked on an ambitious economic reform programme in 1990, which liberalized interest rates and exchange rates, implemented a new public sector law and introduced new financial instruments such as treasury bills, which had an overall positive effect on the economy. Therefore the next logical step after reforming the money market, is to activate the capital market in Egypt. However in order to have an active stock market in Egypt, several improvements have to be implemented which will be addressed in the following chapter.

### **C. Short summary about the stock market in Egypt:**

#### **1. Origin of the Stock Exchanges:**

Several efforts were made during the period 1893-1898 to create a market for the selling and buying of securities in Egypt. Finally in 1898, a successful attempt led to the



creation of an organized securities market at the Continental Savoy Hotel. The group of brokers at that time, who were foreigners and about forty in number, selected from their own entity, committees vested with wide powers for management, for listing securities on the quotations board and for arbitration and disciplinary action. When operations assumed large proportions in Cairo and Alexandria regions, the need rose for creating a specialized stock exchange. However it was only in 1903 that the Egyptian government showed interest in the organisation of exchanges and appointed an International Committee for this purpose, which in turn recommended the establishment of the Cairo and Alexandria Stock Exchanges as well as of the Alexandria Futures market. On 8th November 1909, a High Ordinance was promulgated relating to Cairo Stock Exchange regulations providing that it would become effective as from 1st September 1910. On the other hand, the regulations of Alexandria Stock Exchange were issued in 1913. Since the beginning of this century and to date the regulatory form of the stock exchanges in Egypt followed the French system i.e. statutory monopoly.

According to El Seuofi (Interview, January 1991), the oldest stockbroker in Cairo Stock Exchange, in the 30's the Cairo Stock Exchange was rated number five in the world in terms of its overall trading. Further Hammed (Abdel Gafaar, 1992) another stockbroker in Cairo Stock Exchange, mentioned that in the 30's, the number of traded companies were about 200, the number of shareholders reached ten thousands and the number of transactions were approximately 500 per day. By the 1990's the

situation was drastically reversed and the major reasons for this will be examined in the next chapter.

Here we present first the various stages that the stock exchanges in Egypt have passed through since the 1930's and to date.

## **2. The first phase (1930's-1952):**

Between the period of the 30's and up till 1952 Revolution, the economy was free and the private sector was dominant. Concerning the stock market, both Cairo and Alexandria Stock Exchanges were very active. The majority of brokers were foreigners. In addition a lot of economic and financial newspapers were available and were published in different languages due to the presence of foreigners. Those newspapers had special pages that dealt with stocks, bonds, raw materials and commodities markets. From the investors' side, it is worth noting that Egyptians reacted positively to public stock subscriptions made by Bank Misr's Group due to the success of these projects as well as the existence of a high Egyptian nationalistic sentiment towards Egyptian managed and owned companies.

## **3. The second phase (1952-1970):**

During this period, Egypt followed an economic policy which was based on socialist planning. As a result the role played by the private sector became very marginal. As for the stock exchanges, the picture was gloomy. Both Cairo and Alexandria Stock Exchanges were closed and stopped playing any role in the economy. This made Egyptians afraid to invest in any types of securities for fear of nationalization. Instead



they invested their money on durable goods or precious metals to secure themselves against any unpredictable laws undertaken by the political system.

Finally it should be pointed out that the bond market in Egypt was very limited due to the low coupon rate offered on government bonds and the government rarely resorted to bonds for financing its budget.

#### **4. The third phase (1970-1981):**

Since 1973 great efforts have been made to replace Nasser's socialist planning with an open door policy that encouraged foreign investment and the private sector. Despite the open door policy, the new investment laws did not provide all the required guarantees that would make Egyptian investors start having confidence in their economy. This was reflected in the reluctance of investors to buy shares as they still have not recovered from the losses they incurred in the 60's due to the confiscation of their investments by the State.

In addition there were neither specialized magazines nor newspapers that provided investors with any information about the listed companies on the exchanges; the majority of companies listed on the exchanges were closed companies that were not traded and moreover the T.V. as the most important media, did not assume any role in educating the public about the stock market and its role in the economy. All these negative factors together with the sudden change in the economic regime without having a well developed and prepared financial system resulted in the stagnation of the stock market in Egypt.

## **5. The current phase (1981-1992):**

In May 1992 Al Ahram newspaper mentioned that the Egyptian government is currently studying a new capital market law to be brought in at the end of 1992. The proposed new law is expected to enhance the role of the capital market in Egypt. It should be pointed out that though the proposed law succeeds in removing many impediments towards investments in securities, several analysts are doubtful about the extreme controls allocated to the Capital Market Authority which they think could undermine the efficiency of the capital market. Later we will examine in more detail the advantages and drawbacks of the proposed law.

Meanwhile we conclude this part by referring to some of the key indicators concerning the Cairo Stock Exchange. According to the Cairo Stock Exchange statistics (1989) as given in Table (7.7), the number of listed companies was 510 in 1989. However about 70% of those companies were closed ones, while the rest were open for public offering, Mahrous (Interview, January 1991). He added that the average number of companies traded monthly amounted to 60 companies, out of which only 25 companies could be called actively traded.

The market capitalization was L.E. 4666 million. Concerning the value traded, it was L.E. 210 million. Finally the turnover ratio of the shares traded on the exchange in 1989 was equal to 4.5%. This clearly shows that trading in shares was trivial. The picture becomes worse when Egypt is compared to other developed and developing markets as displayed in the lower section of the Table (7.7).



## **6. Functioning and organisation of Cairo Stock Exchange:**

According to the current Stock Exchange Law 161/1957, the Stock Exchange is a public entity empowered to manage its funds and to litigate being under governmental control through a Government Commissioner. The duties of the Commissioner are to supervise the implementation of laws and regulations and to attend all meetings of the various stock exchange committees with power to raise objection if there is any violation of the laws of the Stock Exchanges or of public interest. Now we will discuss the main factors that affect the operation and performance of Cairo Stock Exchange.

### **a. Brokers:**

- In Cairo Stock Exchange there are currently thirteen brokerage firms and sixteen brokers, since three out of the sixteen brokers are joint partners in these thirteen firms. Brokers are granted by law the privilege of dealing in securities whether they are listed on the stock exchange or not.
- The stock exchange commission is composed of seventeen members. Nine are active members chosen from brokers, five are joint members mainly companies and banks engaged in the field of securities and finally three members are appointed by the Minister of Economy for two years. As one can clearly observe from the above, brokers dominate the Exchange's Committee decisions.
- The Committee's main tasks are: ascertaining the proper functioning of the Stock Exchange, exercising the disciplinary power against all stock exchange members and in case of serious

emergencies setting down maximum and minimum prices for securities.

- The commission paid to brokers by their clients are standardized as 0.5% on the market value of shares and 0.2% on the face value of bonds.

**b. Listings:**

- There are two types of listings for companies on the exchange:

- i. Official list:** companies that have acceptable and approved financial statements by the exchange and they have printed their shares.

- ii. Temporary list:** companies that have acceptable and approved financial statements but they either have not fully subscribed their capital or/and they might not have printed their shares.

- Listing on the exchange is obligatory by law which states that joint stock companies should be listed on the stock exchange if they have capital that amounts to L.E. 250,000 in case of closed companies and L.E. 500,000 in case of public limited companies.

- It should be pointed out that about 94% of the exchange revenues come from listed company fees with the remainder from subscription income. The ultimate effect of this revenue is to pass through to company shareholders the cost of the exchange whether they trade or not. According to Bishop (1986), there is no other exchange in the world that relies so exclusively on listing income.

- Being listed on the exchange, irrespective of trading, grants



the company a tax exemption that amounts to 18% out of its paid up capital.

- As mentioned before the number of actively traded companies on the exchange is trivial compared to the number of listed companies. Further trading is very infrequent because investors that buy profitable companies will not easily resell them since the number of actively traded successful companies on the market is limited.

- Another peculiar feature in the stock exchanges is that some joint stock companies, whether Egyptian or foreign, have their capital denominated in several currencies i.e. dollar, mark, sterling etc.. besides the Egyptian pound (L.E.). It should be pointed out that the shares issued in various currencies are of the same class and enjoy the same rights and privileges.

The reason for the multiple currency shares is that company founders thought that this policy will result in a higher return on their investment. However the problem encountered from the late 80's was the depreciation of the Egyptian pound vis a vis the dollar which affected the shareholders who had dollar denominated shares, since they got less return i.e. dividends on their investments and at the same time they could not realize the capital gain on the shares because no one was willing to buy these shares.

#### **c. Trading on and off the exchange:**

- There are two types of trading that can be executed by brokers:

**Mariage:** where one broker has two clients with a given price.

**Immediate operation:** where there exists two brokers and two

clients.

- There are **three different ways of expressing customers' orders:**

**1. Fixed price:** whereby the customer will determine a minimum price for selling and a maximum price for buying so that the broker can not sell below that minimum nor buy above the maximum.

**2. Price at best:** the customer will require that buying or selling be effected at the best price.

**3. Opening or closing price:** the customer may decide that the operation be executed at the price offered at the beginning of the session or the price at the end of the session.

- The trading unit must be 25 shares or their multiple. Therefore official prices to be quoted are confined to deals transacted in such units, while prices concerning deals transacted in smaller/larger units are recorded on the board without being considered official prices.

- Trading on the exchange floor may only take place with respect to securities listed on the official or temporary list and at prescribed times i.e. 10 a.m. to 1 p.m., Sunday through Thursday.

- On the other hand **OTC i.e. Over the Counter or trading off the exchange** occurs when companies are not listed on the official nor temporary lists. In this case trading is usually limited to the founders of the company or their relatives. According to Bishop (1986) the prices of OTC trading appear to be arms length negotiated prices or nominal transfers or told prices with no logical basis. Trading off the exchange is quite



alarming if one knows that 65% of trading in 1990 was off the exchange. The reason behind this significant off exchange trading is that brokers get a higher commission, Mahrous (Interview, January 1991). At the same time investors want to avoid buying/selling shares through the exchange since the majority of these deals are transfer of shares between management or owners in closed companies and because of the high costs associated with official trading.

**d. Structure and regulations:**

- Transaction fees incurred by brokers amount to 0.2% of the market value of shares with a maximum of L.E. 24 and a minimum of P.T. 60. (1 L.E. = 100 P.T.) which is of course very low.
- Although the return on bank deposits is interest free in Egypt, 50% only of dividends are tax exempt whereas the other 50% are subject to the general revenue tax without limit plus the 1.2% stamp duty paid by shareholders. In addition shareholders pay 0.5% commission to brokers as well as 0.5% to commercial banks for the collection of dividends. Of course all these costs make investment in stocks expensive and less competitive compared to other investment instruments such as bank deposits.
- It should be referred to that the transfer of shares in the secondary market is very slow. If an investor buys shares from another, the transfer of ownership should be concluded after five days by law. On the contrary it actually takes more than a month to conclude the transfer. Of course the present stock transfer system is an intolerable barrier to future trading growth and needs reform by law.

- The secondary market is very thin and investors cannot redeem their shares when they need money due to the lack of financial institutions such as unit trusts, investment trusts, pension funds, clearing agencies etc..
- There is no margin selling in Egypt and stocks are not used as collateral for loans.
- By law, trading on Cairo Stock Exchange dictates that prices cannot change by more than 10% on any trading day.
- Brokers on Cairo Stock Exchange have no publications and no one is responsible for constructing a stock index for the market.
- In short, Cairo Stock Exchange is stagnant, thin and large trading volume is infrequent and occurs mainly in closed companies.

#### **D. Technical analysis of the performance of Cairo Stock Exchange:**

##### **1. Price movements hypothesis:**

In a fully informed and highly competitive market, one expects prices to change randomly without following a given pattern as explained by Kendall (1953) and Roberts (1959). According to the market efficiency theory, prices at any point of time in financial markets reflect the information available at that time i.e.  $P_t = f(I_t)$ . Thus changes in information means changes in expectations which will cause changes in prices. Over time we expect price changes to be positively biased because of inflation and supposedly investment will earn a positive rate of return.

Roberts (1967) defined three levels of market efficiency. The weak form of efficiency in which prices reflect all information



contained in the record of past prices. The semistrong level of efficiency in which prices reflect not only past prices but also all other published information. Finally the strong form of efficiency in which prices reflect not just public information but all the information that can be acquired by detailed fundamental analysis of the company and the economy.

The general trend now is having more efficiency in the markets even if there are occasionally some systematic errors. This means that all the available published information will be reflected in the prices i.e. semistrong form of market efficiency. Therefore one should not expect investors to outperform the market through reading the financial papers or as Brealey and Myers (1988) stated there exists no way for most investors to achieve consistently superior rates of return.

In investigating how stock markets will react to the market efficiency theory, Sharpe (1985) mentioned that the major securities markets appear to conform quite well to the model of weak form efficiency and somewhat less well to the model of semistrong efficiency.

Given the lack of accurate, timely and costless information to investors, one can presume that the weak form of market efficiency will also prevail for the Egyptian market.

## **2. Market indexes:**

Concepts of market efficiency can be applied to individual stocks and to markets as a whole. Thus movement of markets, as opposed to individual stocks, can be expressed in terms of an index of the component stocks. Typically a capitalization weighted index is used to reflect the

differential impact of the sizes of companies, as reported by Bradley and Teweles (1987). A stock index will reveal the overall trend in the equity market. In other words how in general the market is performing? Thus the index will be the professional investor's yardstick for the level of the whole stock market, against which the performance of individual stocks can be measured or judged.

Indexes are world wide instruments used by share investors in developed markets such as London, Paris, New York and Tokyo as well as developing markets such as Taiwan, Thailand and Korea. The importance attached to indexes is due to the fact that they act as indicators of business conditions since stock markets are believed to be sensitive to business conditions.

The advantages of the FT All Share Index as defined by the Financial Times are as follows:

- It accurately reflects the whole market. With over 710 constituents it has a very broad coverage, taking in over 80% of the aggregate capitalization.
- It can be used as a measure of the markets' behaviour over long periods.
- It serves as a reliable yardstick against which to assess portfolio performance. As a weighted arithmetic index, it is designed to behave as an actual portfolio would behave.

Finally to finalize our discussion about the significance of indexes, reference is made to the statement made by London Stock Exchange Deputy Chairman (1991): "Share market indexes have had a long and useful history as real time indicators of market level and direction. They are literally the stuff of



which headlines are made. The public view of the health of the share markets, and indeed the public confidence in making further investments in shares is generally a reflection of what the market index is saying. The index is also often interpreted as a barometer of public confidence in the economy, the government or even the ebbs and flows of world trade and world politics."

### **3. Construction of CASI and Tourism Index**

#### **a. No index for both Cairo and Alexandria Exchanges**

First it should be indicated that in Egypt there are no published stock indexes for both exchanges in Cairo and Alexandria. Nevertheless the Capital Market Authority calculates an index for Cairo Stock Exchange on the basis of the Dow Jones Industrial Index, only for training purposes but it is not published for use. The Capital Market Authority officials refused to tell the writer any details about their used procedure for constructing the index such as the number of companies included, is it a price or return weighted index, how they dealt with companies that were not traded for long periods etc..

The only point they emphasized is that they viewed the index as a sophisticated tool that is not justifiable for the time being since all the concerned parties already know that the market is inefficient and inactive. Finally they asserted that their main task is to try to activate the market not to construct an index.

#### **b. Importance of having an index for stock exchanges in Egypt**

Even though it has been proclaimed before hand that

the stock market in Egypt is sluggish and inefficient, an index is still one of the basic valuation indicators that should be present in any capital market. Hence the declaration by the CMA officials that they will concentrate on the activation of the stock market without having an index is unacceptable.

Therefore if the authorities in Egypt were serious about the revival of its stock market, one of the first things that should be present is an index. The index will reflect to the public as well as to the users of the exchange that the government is trying to improve the overall image of the exchanges to become modernized and efficient, in order to be competitive with other developed and emerging capital markets. This new image could be fostered if the index construction was accompanied by computerized floor trading and a quicker settlement system.

Finally the existence of an index will allow for the first time economists and analysts in Egypt to examine whether the stock market is a barometer for overall economic conditions or not. In other words they would be able to examine if there is any correlation between the performance of the stock market in Egypt and the economy in general.

#### **c. No index is created for Egypt by the IFC**

It should be pointed out that IFC constructs indexes for approximately thirty emerging markets that comprise a diversified range of countries. Within this range, Korea and Thailand represent very developed markets if compared to the rest of the markets. Then Greece, though an EEC country, has a less active stock market than the other European countries.



Zimbabwe and Nigeria exemplify the countries with oldest stock exchanges and finally Jordan and Morocco embrace arab countries which had stock exchanges only a few years ago.

Unfortunately neither the IFC nor Datastream construct an index for Egypt. One of the reasons behind excluding Egypt from their analysis could be the problem of getting updated and timely information about stock prices and returns in Egypt. Another could be that minimal trading in Egypt makes the costly, time consuming compilation and sorting of its data outweigh the benefits of the derived results.

#### **d. Methodology used for constructing CASI**

##### **i. Gathering information from Cairo Stock Exchange**

- It should be mentioned that the daily published journal by Cairo Stock Exchange includes the following items: name of the company, number of outstanding shares, par value, name of the sector, currency, latest dividends and latest price. On the front page of the journal, the names of the traded companies on that day are recorded as well as the prices they were sold with and the closing price for the day.

- An important point to note is that the daily journal, approximately 18 pages, is quite cumbersome and difficult to use. Some of the companies' names are written in English while the others in French, prices are sometimes reported in pounds and other times in piasters and the traded volume and value of shares are not reported. It includes all the listed companies on the exchange despite the fact that the majority of them have not been traded for a long time. Finally since the data in the daily journals is not stored in a computer format but kept in

a manual system, it is not unusual to have some of the issues missing.

- As one can observe from the above, it is very complex to make use of the daily sheets, therefore the writer had to use the internal records prepared by the stock exchange staff. The internal records are organized so that each page represents a day and contains the name of the traded companies, number of shares traded, number of deals per each company and the market value of shares. In case there was no trade as brokers fail to match orders, the bid or ask price is quoted as the closing price. The irony is that though the stock exchange calculates the traded volume and value, it does not publish them for external use.

- The writer took permission from the Cairo Stock Exchange to photocopy 500 daily trading sheets that represented years 1989 and 1990.

- Nevertheless the daily trading sheets that the writer got from the stock exchange officials were not sufficient for the construction of the index since they did not include the number of outstanding shares per traded company which is the main element to be used in calculating a weighted capitalization index.

- Therefore the writer had to employ also the daily journals published by the stock exchange. Since it was quite unreasonable to buy all 500 daily sheets, plus bearing in mind that the capital change for the listed companies will be infrequent, it was quite plausible to get only 24 daily journals, where each sheet represented a month in the two year



period. Finally in the choice of the 24 monthly sheets, the writer asked the brokers about the most active week within the month. The answer was that they do not know exactly but they suspected that the second week of the month was the most active. Based on their assumption, the writer chose the second Sunday in January 1989 to be the first sheet, next the second Monday in February 1989 was chosen as the second sheet, then the second Tuesday in March 1989 was chosen as the third sheet and so on.

- In short the gathered information was about 500 daily trading sheets for years 1989 and 1990 from the internal records of the exchange and 24 monthly sheets (journals) published by the exchange.

- If a company issues its shares in more than one currency, the par value is calculated based on the exchange rate between the Egyptian pound and the foreign currency on that day. Further if the company had two or more issues, the par value of the second issue will be the same as the first issue for the shares in Egyptian pounds while that of the foreign currency will change due to the fluctuations between the Egyptian pound and the other currencies.

- It should be remarked that in the calculation of the daily index, the writer did not design a separate running for each currency but instead regarded currencies having the same footing. Though this is a shortcoming in the analysis, it is still acceptable because shares denominated in other currencies have the same rights as L.E. shares with only one difference i.e. the treatment of dividends. In addition it was observed

that more than 85% of the daily sheets were concluded in Egyptian pounds i.e. the majority or bulk of the trade was done in L.E. Finally as this exercise is accomplished for the first time in Egypt, it was thought best to have an overview of the whole picture without any alterations or refinements.

#### **ii. Cairo All Share Index (CASI)**

The main objective behind creating a daily price index for Cairo Stock Exchange is to establish a measure of the market's activity and behaviour, which does not yet exist. In other words the contribution of this exercise lies in the fact that it will inform users for the first time how prices are moving and their reaction to general economic/political conditions. In addition through this measure, the writer will be able to conduct some tests of the Egyptian market efficiency as compared to other developed and emerging markets. Finally having a stock index that portrays the level of efficiency and activity of the Egyptian stock market, the scope of using the stock market as a means for privatising five star hotels in Egypt can be examined.

- Technically speaking through creating a daily price index, one is able to observe whether the index reflects the changes in the market sentiment or not i.e. is it responsive to new additions, departures and to periodic changes of its members.
- The technique used by the writer to construct Cairo All Share Index was similar to the one used by the Financial Times All Actuaries Index with few incorporated modifications to suit the Egyptian case which were as follows:
- All shares were included in our analysis to avoid making



complicated assumptions. First it is difficult to disregard the non traded companies or the majority of listed companies will be excluded. Second on what basis will companies be disregarded i.e. companies that were not traded for the last five years year or two years or year or six months, will companies be disregarded if their capitalization was below a certain amount etc..

- In case there was no trading, the offer and bid prices were used as the closing prices of the day. Otherwise the last market price was used as the closing price of the day.

- Companies listed on the exchange have neither stock splits nor rights issues, so this did not pose a problem for the index construction.

- The time period for calculating the index was two years i.e. 1989 and 1990. The reason for having a small time span was that the writer gathered the information from the stock exchange in December 1991 and since the records for 1991 were incomplete, it was decided to take earlier years. Further Cairo Stock Exchange officials were first reluctant to allow the photocopying of their internal records and agreed to photocopy only two years upon the presentation of a letter from Aston University that the data will be used for research purposes. Finally it should be indicated that two years is more than enough to give us an overall picture of the performance of the Cairo Stock Exchange, taking into consideration the enormous amount of data involved and the complex nature of sorting, inputting and programming it.

- The Cairo All Share Index is based on a formula that relates

the current market capitalization of its members to the market capitalization at the base date adjusted for intervening capital changes. According to Crowe (1965) this type of index is a base weighted arithmetic average of price relatives, the weights used being the initial capitalization of the index constituents. The index is continuously rebased to maintain continuity when capital changes occur. Thus in principle the index consists of chain linked series where each link occurs at the point of time of a capital change. As indicated earlier, since capital changes for the listed companies are available only in the monthly sheets, then the links are calculated only 24 times when the monthly sheet changes and reveals a capital change.

Thus this index will depart marginally from the underlying true index if one has used instead the daily journal published by the stock exchange. However one does not expect much variance between the calculated and true index given the inactive nature of the stock market in Egypt.

Until the first capital change occurs, the index  $I_t$  will be calculated using formula (1) which is:

$$I_t = \frac{\sum_i \left[ \frac{\text{Market value } i \text{ at base date} \times P_t/P_b}{\sum_i \text{Market value } i \text{ at base date}} \right] \times 100}{\sum_i \text{Market value } i \text{ at base date}}$$

For constituents  $i$ , base date  $b$ , time  $t$ .

By definition, therefore, the first value of the index will be 100 because the price when  $t = b$  will be equal to the price at  $b$  or the base period.

When a capital change occurs, a chain index procedure is used



whereby a link is calculated. Hence after a change at time  $S$ , formula (2) for the next link of the index at time  $(t)$  which is later than  $S$  will be as follows:

$$\text{Link}_t = \sum_i \left[ \frac{\text{Market value at } S \times P_t/P_s}{\sum_i \text{Market value at } S} \right] \times 100$$

For constituents  $i$ , link date  $S$ , time  $t$ .

Hence the index will be the multiplication of  $\text{Link}_t$  with  $I_t$  or the index at the capital change as seen in formula (3):

$$I_t = \text{Link}_t \times I_t$$

- It should be indicated that the writer used two software packages i.e. Dbase IV and Lotus 123, for the calculation of both indexes.

- The writer constructed a program with Dbase IV to calculate the daily index for two years i.e. 1989 and 1990. The designed program has a routine that checks each record in the daily traded sheets to get the name of the company, its currency and its market price. Then it takes the company's name and searches for it in the monthly sheets to get the company's price at the base period as well as the number of its outstanding shares. Then the program calculates the market capitalization for this company at both the current and base period. Next the index for the first constituent or company is calculated using formula (1). This procedure continues till the trading day changes and at that point the program sums up the previous index calculations to arrive at the index for this day and the same process is repeated till a capital change occurs and then  $\text{link}_t$  is calculated using formula (2). As indicated earlier  $\text{link}_t$  is

computed 24 times as the base market capitalization changes 24 times only. Once  $link_t$  is calculated, we use formula (3) to calculate the daily index and then the same routine is done again.

Reviewing Table (7.1), one can observe that from the period 8/1/89 till 12/2/89, both  $link_t$  and  $index_t$  are the same since no capital change has yet occurred. However when the first capital change occurs on 13/2/89, we start having different values for  $link_t$  and  $index_t$ .

Thus on 14/2/89, the index was  $99.46 \times 99.83/100 = 99.29$ .

- It should be pointed out the running of the program was very slow due to the enormous size of the data and the low speed of the used computer.

- In addition the writer calculated the daily index for the 'tourism sector' since we are concerned with the privatisation of this sector. It should be remarked that the tourism sector included about thirty five companies and there were very few hotels listed on the exchange. In particular the three hotels that we valued in the previous chapter were not quoted on the exchange.

- In Tables (7.1) and (7.2) the reader will find enclosed the daily  $link_t$  and  $index_t$  for years 1989 and 1990 for the whole market and the tourism sector.

#### **e. Analysis of Cairo All share Index and Tourism Index**

##### **i. Movement of both indexes**

As stated previously both indexes were designed to act as tools for measuring the performance of the equity market in Egypt plus giving a view of the short term sentiment of the



stock market and the tourism sector per day.

From Tables (7.1) and (7.2) as well as Graphs (7.1) and (7.2), one can easily perceive that price fluctuations were very small all over the period which reflects the stagnancy in the Egyptian stock market and its overall inactivity. From the graphs one can observe that Cairo All Share Index i.e. CASI fluctuated only between 97 and 107 through the two year period, whereas the majority of the fluctuations were around the base period index i.e. 100. If one considers the various events that occurred especially in 1990 such as the implementation of the economic reform programme in Egypt, the debate about privatisation in Egypt, the Gulf War, one can infer that the index reacted very poorly to those events. This reflects the inefficiency of the Egyptian stock exchange i.e. prices are not reflected in the security prices, but at the same time one cannot ignore the fact that more than 70% of the listed companies on the exchange were not traded which had undoubtedly pushed the index downwards.

The same picture can be depicted in the Tourism index with only one difference is that there were more fluctuations in the prices i.e. between 70 and 130. However those irregular large increases and decreases in prices were less in number than those that occurred for the whole market. In other words, the whole market index had more fluctuations around the base index than the tourism index but their magnitude were lower than those of the tourism index. Of course such outcome was anticipated because the tourism sector is a subset of the whole market and thus one expects it to have a higher unsystematic

risk.

In short the whole stock market had a mean of 100.30 and a standard deviation of 1.47 whereas the tourism sector had a lower mean of 99.17 but a higher standard deviation of 4.75. Since the standard deviation measures the volatility of changes in the index, one can assert that the tourism index was more volatile than the whole market index.

#### **ii. CASI index versus Tourism index**

The next analysis that was performed was to try to investigate whether there was any relationship between CASI or whole market index and the tourism index. Using Minitab software, a regression model between the tourism index (dependent variable) and CASI (independent variable) was computed for the two years 1989 and 1990.

From the regression equation in Table (7.3), one can infer that an increase in the market index by one unit will result in a decrease in the tourism index by 0.212.  $R^2$  or the coefficient of determination was found to be 0.4%. It should be indicated that  $R^2$  measures the proportion of the total variation in Y or tourism index that is explained by X or the market index.  $R^2$  was nearly zero. In other words the regression model explained only 0.4% of the variation in the tourism index.

Looking at the t statistic test using a confidence interval of 95%, one will discover that the calculated  $t^*$  was -1.45 which was greater than the critical  $t_c$ , which makes us accept the null hypothesis that the coefficient of the regression is equal to zero no matter what the value of  $X_i$  is. In other words the explanatory variable X or market index has no effect on the



dependent variable Y or the tourism index which was already depicted in the  $R^2$  result.

Finally the last statistical test that was effected was the correlation coefficient between the market index and the tourism index which was -0.066. This shows that the tourism index was negatively but very loosely correlated with the CASI which again confirms our previous findings.

### **iii. Most volatile day in the week**

Continuing with our technical study of both indexes, an attempt was made to find out whether there was one day where fluctuations were more apparent than the rest of the days of the week or not. In other words we wanted to investigate on which day of the week was the market most volatile.

To conduct such test, the mean and standard deviation were calculated for each day separately. This exercise was done twice, the first time for the whole market and the second for the tourism sector as displayed in Table (7.4). The findings were:

- Sunday was the most volatile day for the whole market with a standard deviation of 1.60 followed by Monday with a standard deviation of 1.56.
- For the tourism sector Monday was the most volatile day with a standard deviation of 5.50 followed by Thursday with a standard deviation of 4.92.
- Thus one can note that the beginning of the week is more volatile than the rest of the week for both the whole market and the tourism index.

- Finally it should be remarked that in our test we did not calculate the number of deals per day because this measure will show the day that had the most business but will not necessarily reflect the day that had the large fluctuations in prices.

#### **iv. Effects of events on both indexes:**

Before discussing the effect of events on the two indexes, we will first display the relevance of efficient capital markets hypothesis to events.

An efficient capital market means that the information is widely and cheaply available to investors and that all the relevant and ascertainable information is already reflected in security prices. Roberts (1967) has defined three levels of market efficiency. The weak form is where prices reflect all information contained in the record of past prices. The semistrong form is where prices reflect not only past prices but all other published information. Finally the strong form states that prices reflect not only published information but also all available information about the company as well as the whole economy.

In developed capital markets, prices quoted by market makers will be adjusted continuously in reaction to news, whether it is corporate events or general economic indicators. That is why one would expect prices to move randomly either upwards or downwards depending on the nature of the announcement.

Sterlini (Interview, July 1992), an analyst on London Stock Exchange, remarked that the initial reaction to an event will be a mark up or down on the same day. Then later there will be



a follow through which will determine whether the original increase or decrease in the price will be sustained. An example to illustrate this was during the last General Election in the U.K. in April 1992. Few days before the election, the stock market reacted negatively i.e. moved downwards for fear of a Labour Party win, then it adjusted upwards after the Conservative Party was re-elected.

In this section we will try to investigate the weak form of market efficiency for the Tourism Index in Egypt.

To achieve this task, two exceptional events concerning the tourism sector were selected from the most widely read daily newspaper in Egypt i.e. Al Ahram. The writer used the microfiche facility at the American University in Cairo in early 1992 to review the announcements made by officials in Al Ahram newspaper in 1989 and 1990 related to the privatisation of the tourism sector. Then she chose the two most remarkable announcements, in order to examine their impact on both the Tourism and Cairo All Share Indexes.

A graph was then plotted to view the movements in both indexes before and after the event. In this exercise, a ten day period was used before and after each event which is of course a long time period, if compared with developed capital markets. Bradley and Teweles (1987) indicated that an efficient market is often able to discount news successfully a considerable period in advance. Thus the effect of good/bad news is expected to be already discounted by the market before the event occurs. On the other hand a longer time span was used in our analysis due to the inactivity of the stock market in Egypt and our

expectations that there will be a time lag in the reaction of the market to events. In other words one does not expect the stock market in Egypt to react to the news before it occurs nor on the day of its occurrence, but rather after its occurrence by several days.

The first event on 10/8/1989 was an announcement made by the Minister of Tourism: the sale of 30% of tourism public sector companies that will be privatised to their employees.

The second event on 5/4/1990 was an announcement made by the Chairman of the Public Sector Tourism Authority: the sale of Meridien Cairo Hotel by Egoth for \$75 million to adjust its capital structure and the government's future plan to sell the Nile Hotel to Egypt Air in order to upgrade the hotel.

\* Reviewing Graphs (7.3) and (7.4), that relate to the first event, one will note the following:

- Concerning the sign of the change in the tourism index, one will find that it was fluctuating between negative and positive.

- In particular before the event by four days, on the 6th of August there was a large drop of -3.41, followed by a slight increase on 7th of August of 0.83, then a big positive jump of 4.02 on the 8th of August, which was the largest over the whole period. Then on the 9th and 10th of August there were slight reductions in the index by -0.21 and -0.59 respectively. Afterwards the index slightly increased by small units less than 1.0 till the 16th of August. Between the 17th and 24th of August, the index was once more fluctuating between negative and positive signs but at a smaller magnitude.



- In studying the impact of this event on Cairo All share Index, one will note that the fluctuations of the index were much smaller and the change in the sign of the index followed a random pattern all over the period.

#### **First Event (E1)**

Trading days		Before E1	After E1
Mean	Tourism index	95.18	98.01
STD	Tourism index	1.67	0.59
Mean	CASI	99.24	99.41
STD	CASI	0.37	0.48

- If one calculates the mean and standard deviation for the ten days before and after the event, one can depict that the mean of the tourism index was increased after the event by about 2.83 i.e. it reacted positively to the event. The standard deviation was lower after the event which shows that before the event there were more fluctuations that settled down after it.

- Concerning CASI, one can note that the ten days period after the event had a larger mean than the ten days before the event but the difference between them was rather low i.e. 0.17, as for the standard deviation it was slightly higher after the event i.e. 0.11.

- Reviewing the number of companies traded in the tourism sector during this period, we will find that they were only four. [1].

\* Reviewing Graphs (7.5) and (7.6), that relate to the second event, one will note the following:

- The event has caused fluctuations with a large magnitude on the tourism index, in specific between the 26th and 28th of March, there were positive changes of 1.18, 2.06, 1.08 accordingly. However on the 29th of March there was a sharp

drop of -4.01 followed by a slight increase of 0.31 on 1st of April. Then the index was constant till the 4th of April. On the day of the event i.e. 5th of April there was a sharp increase of 2.67. Next there was a big drop of -2.98 on the 6th of April followed by a further decrease of -1.2 on the 9th of April. Then once more there was an increase of 1.2 on the 11th of April and then there was a decline that continued till the end of the period.

- In studying the impact of this event on Cairo All share Index, one will note that there were random positive and negative fluctuations at the beginning of the period. The magnitude of change was higher than those encountered in the first event. Also the negative changes were more than the positive ones especially during the day of the event i.e.

-1.92, which continued till the end of the period.

### **Second Event (E2)**

Trading days		Before E2	After E2
Mean	Tourism index	100.56	97.10
STD	Tourism index	1.43	2.02
Mean	CASI	103.20	99.26
STD	CASI	1.87	0.60

- The tourism sector reacted negatively to the event. The ten day period index after the event was 3.46 lower in magnitude than the ten days prior to the event. As for the standard deviation it was increased by 0.59.

- As for Cairo All Share Index, it exhibited the same downward movement after the event by 3.94 and its standard deviation was reduced by 1.17.

- Reviewing the number of companies traded in the tourism sector during this period, we will find that they were only



three. [2].

In conclusion one can infer that both events had an impact on the tourism index as well as Cairo All Share Index i.e. the first caused a positive disturbance while the second caused a negative disturbance. Further the few companies traded throughout this period were not involved with the news. Nevertheless one cannot completely rule out the possibility that the tourism index might have partially reacted to the event because of brokers trying to settle down the accounts of those few traded companies.

#### **4. Cairo All Share Index & other capital markets indexes**

In order to explore the relationship between the Egyptian index and other countries indexes, considerable use was made of data on other exchanges' indexes drawn from Datastream. Datastream mounts indexes for markets denominated in local currencies and in U.S. dollars as well as for many developing countries covered by the IFC. Indexes reported by the Datastream are either in weekly or monthly series. Further to the market indexes available, Datastream offers a number of exchanges for which a sectoral index of 'Hotels and Catering' is calculated and reported. Data on such sectoral index was captured by the writer in order to test the behaviour of the Egyptian sectoral index i.e. Tourism Index. First in order to compare and test against Datastream indexes, the writer took a subset of the daily Cairo All Share Index and Tourism Index i.e. weekly indexes on Monday. Then the writer input the weekly indexes in Datastream time series program for the period 9/1/89 till 31/12/90. Afterwards use was made of

Datastream statistical program to run the relationship between the Egyptian indexes and some other exchanges' indexes. It should be reported that the writer would have preferred to choose Sunday since it is the first day of the week and the most volatile day in Cairo Stock Exchange. However since Sunday is a holiday for other stock exchanges, Monday was therefore selected as the weekly index. Graphs (7.7) and (7.8) show the movement in the weekly price index on Monday for the whole market as well as for the tourism sector in Egypt.

Several criteria were involved in the selection of comparable indices from exchanges in countries which varied in terms of their location and development. First Jordan was selected because it is an Arabic country with the same language, religion, and would have fairly the same degree of development in its stock market as Egypt. Further countries such as Greece and Turkey were chosen since they lie in the same Mediterranean region and because the latter is well known as one of the developing countries that had successful privatisations through its stock market. Moreover countries such as India, Venezuela and Portugal were selected since they illustrated diverse levels of the spectrum of stock market development. Finally the FT All Share Index was used as an example of a well developed capital market.

#### Findings:

- From Table (7.5), it is notable that there is a very low correlation between the Cairo All Share Index and the IFC Jordanian Index i.e. 0.05112. Also the  $R^2$  was very low i.e. 0.2%.



- On the other hand turning to more active emerging markets indexes, the Cairo All Share Index was positively and highly correlated with the Venezuelan and Indian Indexes i.e. 0.50383 and 0.47406 respectively,  $R^2$  was somewhat high 25% and 22% for the same variables.
- Perhaps surprisingly the FT All Share Index ranked third in terms of its correlation with Cairo All share Index i.e. 0.34542 and  $R_2$  was 12%.
- Turning to integration levels with other regional centres around the Mediterranean, Cairo All Share Index was positively correlated with the Portuguese Index i.e. 0.33305 and  $R^2$  was 11%, more or less similar to its correlation with the FT All Share Index.
- Finally there was some correlation with the less active Greek and Turkish indexes i.e. 0.17762 and 0.27864, despite the fact that all three countries lie in the same region.
- An important thing that one should carefully notice is that the relatively high correlation between the Cairo All Share Index and other indexes does not prove that there is a cause and effect relationship.

From the above results one can observe that the Egyptian market showed linkage with relatively efficient, active, emerging markets such as India and Venezuela and efficient world markets such as U.K. market. This was confirmed by Chiang and Jeon (1991) who declared that the globalization of world financial markets has been one of the most profound changes in international finance during the past decade. They mentioned that the factors that contributed to the world stock market

integration include deregulation, market liberalization, computerized trading systems, rapid development of communication technology and innovations in financial products and services. As a result of that market prices are linked so closely that movements in prices in one national market immediately affect stock prices in foreign markets through efficient information sharing and free accessibility to markets by domestic as well as foreign investors.

On the other hand the Egyptian market displayed less linkage with regional comparators such as Greece, Turkey and Jordan. This is because these regional markets are less active, less efficient markets whose indices will reflect peculiarities of each country rather than regional events, will reflect any systematic events poorly and finally will be inefficient measures of the impact of those events.

Hence one would expect inefficient markets to be positively correlated with efficient markets and less correlated with other similar inefficient markets.

- Graphs (7.9)-(7.13) displayed the relationship between the weekly price index of Cairo All Share Index with the other countries, all based at 100 at the start of the period.

Several graphs were used for the difficulty of having all countries plotted on the same graph.

- As one can view in Graph (7.9), both the Egyptian and Jordanian indexes were static over the period. However the Jordanian index showed more fluctuations than the Egyptian index i.e. 140 range. On the contrary the Greek index started with small fluctuations at the beginning of the period then



there was a noticeable jump in Apr 90 that continued till Aug 90 i.e. 600 range, then the index started to decline which persisted till Nov 90 and then it started to increase once more.

- From Graph (7.10) one can notice that the Venezuelan index initially fell in relation to the Egyptian and Jordanian indexes and it remained lower than them till Apr 90, then it started to increase gradually till the end of the period. Comparing Dec 90 with Apr 90, one can detect that Venezuelan index has increased sharply in this 8 months period i.e. 500 range.

- In Graph (7.11), one can find out that the Portuguese index was very volatile since it started at a lower level than the Jordanian index then it increased sharply in Sep 89 i.e. 160 range. However on Oct 90 it decreased successively till the end of the period, whereby it was lower than the Egyptian and Jordanian indexes.

- In Graph (7.12), one can discover that the Indian index has been outperforming the Egyptian and Jordanian ones throughout the period, in the 200 range. The Indian index tracked alongside the Jordanian one in the beginning of the period, but it surpassed it by Apr 90 and continued increasing till Sep 90, after which it started declining till the end of the period.

- In Graph (7.13), one can notice that the Turkish index has been gradually increasing throughout the whole period at a higher level than other indexes i.e. 1000 range. However starting Oct 90 the index was gradually decreasing to reach 400 in Dec 90. The Turkish index had the highest volatility in

comparison with the other indexes.

- It can be noted that most indexes experienced an increase on Apr 90 and towards the end of the period they all decreased.
- It can be inferred that Turkey, Greece and Venezuela had more volatile markets, in this period, which sharply increased their share values, as reflected in higher indexes. Further though India and Portugal had more volatile fluctuations than the former three countries, the magnitude of change in their indexes was not so large. Finally Egypt and Jordan displayed very low fluctuations in their indexes and represented the less active markets.

#### **5. Cairo Tourism Index and other tourism indexes**

Since hotels represent an important element of our study, we will examine the relationship between the tourism index in Egypt and the Hotels & Catering index of other countries. Unfortunately there were no sectoral indexes computed by Datastream for the former selected sample. Hence we tried to find some countries that could be compared to the tourism sector in Egypt. These countries comprised Italy, Paris, Johannesburg, Amsterdam, Zurich, Hong Kong and London. Although the chosen countries have more developed markets than Egypt, hotels in Egypt can still be compared with them, given the international competitive nature of the hotel industry in Egypt, as previously shown in Chapter (4). Therefore one can be confident that five star hotels in Egypt could be well integrated with hotels elsewhere.

From Table (7.6), one can perceive that the Tourism index in Cairo was relatively strongly correlated with the Milan index



i.e. 0.26281 followed by the Johannesburg index i.e. 0.25064 and then the Paris index i.e. 0.24828. Moreover the tourism index was moderately correlated with other countries such as Hong Kong, Amsterdam and Zurich i.e. 0.15957, 0.13784, 0.12339 accordingly. Finally the tourism index was loosely correlated with London Datastream hotels index and FTA hotels index i.e. 0.09874 and 0.09815.

Graphs (7.14)-(7.17) display the relationship between the 'tourism index' in Egypt and the 'Hotels & Catering index' of other countries.

- The first notable thing in these graphs is that the fluctuations in the Tourism indexes were in the 200 range which was much lower than those for the whole market in the preceding graphs, bearing in mind, the difference in the sample of countries.

- Looking at Graph (7.14), one can spot that at the beginning of the period, Cairo and Milan indexes were fairly similar, however starting Oct 89 Milan index experienced a large increase which continued till Aug 90. Then Milan index experienced a decrease till the end of the period which was lower than Cairo index due to the Gulf War. The effect of the Gulf War on Cairo index was very small and the index even started to increase in Nov 90. On the other hand Johannesburg index was fluctuating all through the period but its overall movement was upwards.

- In Graph (7.15), one can note that Paris index was very closely related to Cairo index. However the Paris index was more volatile and experienced large drops especially on Apr 89

and on Aug 90. Further it took longer times for the Paris index to recover from the drops and reach the original 100 level. On the other hand the Hong Kong index was moving upwards till Aug 90 when it experienced a large drop. However it started recovering slightly on Oct 90.

- In Graph (7.16), one can view that the Amsterdam index was also very closely moving with Cairo index and the range of its fluctuations was rather small i.e. 120. On the contrary the Zurich index displayed more fluctuations throughout the period and as expected there was a drop from Aug 90 that continued till Nov 90, after which the index started to slightly increase.

- Finally in Graph (7.17), one can see that both London hotels and FTA hotels were positively and highly correlated i.e. the two indexes followed the same pattern. Both indexes were very loosely correlated with tourism index in Cairo, where in some cases they were even negatively correlated. As anticipated on Aug 90, both indexes showed a large drop, lower than Cairo tourism index, that remained till the end of the period.

- As expected most indexes were decreased on Aug 90 due to the Gulf War and this drop continued till the end of the period.

- Finally one can conclude that the tourism sector in Cairo was adequately correlated with other developed markets indexes, which confirms with the original idea that hotels in Egypt are competitive with other hotels abroad.

## **6. Cairo stock market in relation to other emerging markets**

In this last section of our technical analysis, we will discuss several indicators in the Egyptian stock market in



relation to other emerging markets. The objective behind such comparative analysis is to measure the activity of trading on Cairo Stock Exchange. Much of the data used in this part was taken from "Emerging Stock Markets Fact Book 1990" published by the IFC. Our analysis will be covering thirty two emerging markets at various levels of development. It will examine those markets in terms of the number of listed companies, market capitalization, value traded and turnover ratio over the period 1980-1989.

**a. Number of listed companies**

From Table (7.7), one can see that this variable has been increasing continually since 1980 and up to 1989, accounting also for increased market capitalization. The percentage increase in the number of companies was highest in 1982 i.e. 75% followed by 1984 i.e. 67.5%. Then in the period 1985-89, the rate of increase has been declining with the exception of 1988 where there was a slight increase of 12.3%. Hence the overall annual compound change in the number of listed companies was 28.6%.

Now looking at Table (7.8), one can discover that Egypt lists 510 out of the total 10,582 firms listed of the emerging markets in 1989 i.e. 4.6%, which is fourth in rank. The highest weight was for India i.e. 54.1%, followed by Korea 5.6% and then Brazil 5.3%. However as we referred to earlier, the majority of the listed companies in Egypt was not traded.

**b. Market Capitalization**

Looking at Egypt's market capitalization and % change in market capitalization in Table (7.7), this variable has been

increasing throughout the period due to two factors i.e. new companies enlisted on the stock exchange as well as inflation. This could be seen in the variance between the market capitalization in L.E. versus market capitalization in \$. The latter was smaller due to the appreciation of the dollar vis a vis the Egyptian pound. It is preferable to use the \$ values to cancel the effect of inflation and to enable the comparison between Egypt and other countries. Thus the annual average compound rate for market capitalization in \$ was 36.3% over the period 1980-1989.

Comparing Egypt's market capitalization to the aggregate market capitalization of other emerging markets, one can realize from Table (7.9) that it was minimal i.e. 0.3% in 1989. This showed that the Egyptian market had an insignificant capitalization compared to the total emerging markets. The highest weight was for Taiwan 38.7% followed by Korea i.e. 23%, where both countries accounted for 61% of the market capitalization of the total emerging markets.

### **c. Value traded**

From Table (7.7), one can view that Egypt's value traded has followed an irregular pattern with an overall annual compound rate of 49.6% for the \$ values. Value traded in \$ has declined in 1981 and 1982. Then it rose sharply in 1983, 1984 and 1986 by 166.7%, 312.5% and 85.6% respectively. However in 1985, 1987, 1988 and 1989, it was reduced by 26.5%, 7.2%, 31.1% and 27%.

Viewing the weight of Egypt's value traded in relation to other markets, from Table (7.10) one can note that it was quite



negligible i.e. 0.007% in 1989. The highest weight was that of Taiwan 83.3% followed by Korea 10.5%, where both countries accounted for 94% of the value traded of the total emerging markets.

#### **d. Turnover ratio**

The turnover ratio is the most important variable since it is the % of the value traded out of the total market capitalization. From Table (7.7), one can observe that Egypt's turnover ratio was 4.5% in 1989, which was very low. The annual average compound rate for the turnover ratio over the period was 13.1%.

Comparing Egypt with other emerging markets, one can observe from Table (7.11) that it ranked twenty first out of twenty five countries. In other words Egypt was one of the last five markets that had the lowest turnover ratios. On the other hand, countries such as Taiwan, Korea and India displayed the highest turnover ratios which were 407%, 86% and 63% respectively.

#### **E. Conclusion:**

From this chapter, one can realize that trading on Cairo stock exchange was minimal and the exchange was stagnant. This was confirmed when we compared Egypt to other thirty emerging capital markets in terms of market capitalization, traded value and turnover ratio. Further our construction of the daily Cairo All Share Index asserted the inactivity of the exchange as viewed in the small fluctuations around the base index or 100. Moreover when we tested the impact of events on the Tourism Index and Cairo All Share index, the indexes showed disturbances several days after the events, which reflects the

weak form of market efficiency. Concerning the Tourism Index, it displayed more fluctuations than Cairo All Share Index and was moderately correlated with other developed countries hotel indexes.



#### Notes and References:

[1] Two of them were traded once and the other two were more frequently traded. Misr Hotels Company was traded 15 times and the fluctuations in its prices were 3% whereas Gizera Hotels Tourism was traded 11 times and the fluctuations in its prices amounted to 10.5% throughout the period.

[2] One of them was traded once and the other two were more frequently traded. Misr Hotels Company was traded 12 times and the fluctuations in its prices was 13.7% whereas Gizera Hotels Tourism was traded 8 times and the fluctuations in its prices amounted to 4.1% throughout the period.

- Interview with El Seoufi, A. Stockbroker at Cairo Stock Exchange, January 1991.

- Interview with Sterlini, P. Stock Index Analyst, London Stock Exchange, July 1992.

- Interview with Mahrous, A. General Secretary of the Cairo Stock Exchange, January 1991.

## **Chapter 8    Prerequisites for having an efficient stock exchange in Egypt.**

### **A. Introduction:**

In the previous chapter, we have examined technically the overall behaviour of Cairo Stock Exchange. The main findings of our analysis were that the stock market in Egypt was very thin, the volume and value of trading were insignificant and the constructed indexes showed only minor fluctuations. On the contrary, Cavazzuti (1990) indicated that London Stock Exchange is considered an efficient market due to: certainty of price in execution of orders, possibility for negotiating large tranches of securities, lower costs because of absence of stamp duty and intermediation fees for those who can directly conclude transactions with market makers and shorter liquidation times. In this chapter we will discuss the measures that constitute efficient stock markets and examine how they could be implemented in the stock exchanges in Egypt to enhance their role and enable them to handle future privatisations.

### **B. Supply of securities:**

#### **1. Efficient markets case**

One of the fundamentals of an efficient stock market is the presence of profitable and well known companies whose shares are frequently traded on the exchange: such actively traded companies usually account for the majority of trading on developed exchanges.

According to Bradley and Teweles (1987) over one third of New



York Stock Exchange sales are concentrated in the 100 most popular issues. The presence of successful and profitable companies will by itself attract private and institutional investors as quality brands attract consumers. The critical mass of traded stocks will give low unit costs and promote information flows and skills.

## **2. Egyptian case**

In the Cairo Stock Exchange more than 70% of the listed companies are closed, non traded companies whether they are private or public companies. Public sector companies have not been allowed to sell their shares on the exchange. Most private companies take the form of family businesses and the number of shareholders is usually limited to the owners of the company, their relatives or employees. They are not willing to sell their shares for fear of equity dilution, loss of power and control and because there are no tax incentives for public offerings. [1]

Furthermore Egyptian private firms rely more on debt finance in particular short term loan from banks. This is because equity funding is costly, involves a lot of regulations and is difficult to get especially for newly established firms due to the lack of underwriters and venture capitalists.

## **3. Suggested reforms**

Paradoxically though one does not usually correct a supposed imbalance by equalizing the regulatory handicap, the excessive dependence on debt funding by Egyptian firms is not expected to continue in the future because new credit ceilings policies enforced by the Central Bank of Egypt will make the

access to debt finance more complex than before. This in turn will compel companies to rely more on equity funding. Unless equity markets are liberalised and stimulated, this may obstruct all routes to new financing.

It is possible that tax concessions would motivate the closely held companies to issue shares to the public. Genesis (1991) suggested that companies could be granted a tax offset equivalent to the amount of new equity capital raised on the stock market. Management's fear to lose control could partially be met through the imposition of a thorough "takeover code". On the other hand Sudweeks (1989) suggested that companies can be granted nontax benefits, as in Jordan where new businesses are allowed limited liability status only if they offer a minimum percentage of their equity to the general public (25% for financial institutions, 50% for industrial and commercial companies). He remarked that the extraordinary development of Jordan's equity market was directly attributed to this law.

### **C. Demand for securities:**

#### **1. Efficient markets case**

It is not enough to have successful companies that are willing to raise funds through public offerings of their shares. One needs interested and willing investors to buy those shares. Active markets consist of investors who operate buy-and-hold strategies, mixed with those who seek returns from arbitrage trading to take advantage of short-term price and return disequilibria. The latter class of investors provides depth and liquidity to markets, and in an efficient and bull market there will be always demand on the shares of active



companies.

Sophisticated private investors in developed markets are affluent individuals that are well informed about the stock market. In other words they are well aware of the high risk/return of equity investment as opposed to other low risk/return debt instruments. Nevertheless the majority of investors in developed markets are institutional investors such as pension funds, investment funds, unit trusts. This reflects the value of portfolio construction, with private investors investing indirectly in shares through investing their savings in financial institutions in order to share management costs and to avoid the unsystematic risks attached to individual stocks. In the London equity market, the percentage of private investors to total investors in 1990 was less than 20%.

## **2. Privatisation will help increase demand for securities**

The lower percent of share ownership by private investors was partially reduced by the introduction of privatisation. According to the World Bank Report (1992), privatisation has helped develop and expand financial markets. It increased the number of shareholders in Jamaica, Chile, Nigeria, U.K., Japan and France.

Country	Number of enterprises sold through exchanges	Number of new shareholders after privatisation
Chile	14	633,165
France	14	5,000,000
UK	14	7,400,000
Jamaica	3	30,000
Nigeria	16	400,000
Japan	1	1,670,000

Nevertheless the impact of such shareholders on the stock exchange activity is difficult to assess, given the case of the

U.K. where 51% of the new shareholders in the privatised companies owned only one share as stated by Goodison (1986).

### **3. Retail market in Egypt**

Reviewing the Egyptian situation, it should be first remarked that a lot of Egyptians lack investment education and experience because there is limited publicity about securities in the media such as T.V., newspapers, magazines etc.. In addition there are no courses offered in the area of security analysis and investment in universities for students who could become potential investors in the future. Furthermore even well educated Egyptians are either unaware of the existence of the stock exchanges or are unwilling to invest in shares whose returns are doubtful if compared to other investment alternatives i.e. bank deposits.

According to Nazmi (Interview, January 1991), a stockbroker on Cairo Stock Exchange, Egyptian investors in securities comprise the following groups:

- a. Experienced and knowledgeable investors of the age group 80 years, who are familiar with security investment since the late 1940's.
- b. Children of the first group who are acquainted with security investment through their parents.
- c. A small percent of expatriate Egyptians who work abroad and have extra funds to invest in securities.
- d. A small percent of university graduates who invest in securities but in very limited amounts.
- e. Insurance companies which represent a new type of investors that started to invest in successful companies on the exchange.



It should be mentioned that the private investors do not undertake themselves the necessary analysis of the companies but depend completely on the advice of their brokers concerning their portfolio construction due to the lack of alternative independent sources of advice. In most cases the main objective of investors is short term oriented i.e. dividends yield, whereas capital gain is not foreseen as an important goal. This is expected because in a thin market, it is difficult, uncertain and expensive to redeem shares as opposed to an efficient market where investors can easily redeem shares because transaction costs are lower and the competitiveness between market makers reduces the spread between the bid and ask prices.

#### **4. Institutional investors in Egypt**

Egypt lacks institutional investors: pension funds, investment trusts, unit trusts, mutual funds and underwriters. There is a growing number of Egyptians who prefer to invest their money in Islamic banks or Islamic Investment Companies that do not pay or charge interest. The recent experience of the late 80's with Islamic Investment Companies, where a lot of small investors deposited their whole savings with them because of the high expected return, proves the fact that there is enough liquidity in Egypt but it needs to be channelled into the right routes.

Existing financial institutions such as insurance companies were forced by the government to invest in low coupon government bonds. However recently they started to invest in shares as mentioned by Nazmi (Interview, January 1991).

Financial institutions in Egypt have no respect for the depth, liquidity and pricing of the Egyptian stock exchanges as mentioned by Bishop (1986). Therefore they do not trade in shares of successful companies that they hold, because market prices are not in their view realistic and it would be difficult to find other profitable companies that they could add to their portfolios.

### **5. Suggested reforms**

It is clear that both supply and demand sides require change. The most significant element that will determine share investment is to gain the investors' confidence in the overall economic conditions which depend mainly on the government's attitude towards investment in general and security investment in particular.

To promote wider share ownership, the present promotion of the stock exchange activities as a medium of investment should be upgraded to attract the public towards security investment. Therefore a wide promotional campaign that promotes investment in shares should be designed, using terminology in the advertisements which is simple, easy to understand, with technical jargon concentrating on the capital gain as well as the current yield provided by shares. In short the procedure adopted should attract the audience and let them become interested in stocks as well as educational since it introduces a new type of investment.

An example to illustrate this point is quoted from the Arab Stock Exchange Conference in Cairo 1987, where one of the speakers cited the use of cartoons on T.V. by the Tunisian



Stock Exchange to introduce stock trading to the public.

Further in the U.K., privatisation issues employed innovative promotional campaigns in the mass media.

Another avenue is to actively promote equity acquisition portfolios among Egyptians working abroad, which is relevant in case of five star hotels that the government intends to privatise through the stock market.

Moreover concerning investors that prefer to invest in Islamic banks or companies, one of the principal points that should be emphasized in the promotional campaign is that investment in shares does not result in uniform dividends but variable returns because it is a factor of the company's profitability, which is similar to what was advocated by the Islamic companies. This will make securities investment acceptable to investors since it conforms with Islam.

As for institutional investment activity in Egypt, the government should encourage the establishment and development of specialized underwriting securities institutions as well as unit and investment trusts since they will be the main parties that undertake risk if the offer issue of shares was not fully subscribed. Commercial banks, insurance companies and pension funds might participate in the underwriting function as well as foreign companies which can provide the know-how especially in the early stages. Hence for Egypt one should not expect deeper share ownership in the near future. Instead the government should concentrate on encouraging institutional investors to invest in equities and at the same time every effort must be taken to stimulate private investors to allocate

part of their savings to these financial institutions.

Genesis (1991) pointed out that the Sri Lankan government has recently passed a legislation granting the possibility to offset against taxable income investments made into local unit trusts. This has sparked the establishment of several competing fund management groups in Sri Lanka and is expected to mobilize significant sums for investment in the domestic capital market. In addition Genesis (1991) referred to the Chilean experience where pension funds with competing managers were established in 1981. Employees were permitted to choose to which fund managers they contributed about 10% of their monthly salaries. The managers competed on the basis of investment return and efficiency. Ten years after their establishment these pension funds control assets of some \$8 billion equivalent to more than 25% of Chile's GDP, of which \$1.8 billion is invested in the stock market.

There is evidence that established institutions wish to operate in Egypt. In Al Ahram newspaper on 29/7/92, it has been reported that seven big international institutions from USA, UK, Japan and Singapore have applied to the CMA in order to operate as underwriters and mutual funds companies on the Egyptian exchanges. This is a very good indicator that reflects the confidence these institutions have in the future economy of Egypt.

#### **D. Brokers:**

##### **1. Efficient markets case**

Brokers provide the link between buyers and sellers of securities. In other words trading in securities is facilitated



through brokers. Otherwise trading would be a very lengthy and expensive process. For their services, brokers will charge their clients a commission. In an efficient capital market, brokers have updated and timely information so they can easily get the best deal, whether bid or ask prices, for their clients. In contemporary exchange practice, the exchange licenses a number of broker members as market makers, trading throughout exchange hours to meet client orders transmitted through brokers. [2]. Market makers undertake the obligation to quote two way prices and sizes to the market for all the securities it is registered in and deal at those prices continuously when approached to do so, even if they have to buy the stock from each caller. Brokers will usually buy and sell shares for their clients from market makers.

## **2. The culture of Egyptian brokers**

In Egypt there are no market makers whereas the number of brokers operating in Cairo Stock Exchange is sixteen: this is adequate given the low trading in the market. The majority of brokers lie in the older age group averaging 55 years old. They used to act as assistants to the former foreign brokers in the 40's and learnt the basic rules for security trading in that era from them. However it should be pointed out that the Egyptian brokers have not developed their skills and are rather conventional in their financial analysis. For instance their judgement is mainly based on the past dividends distributed by the companies and on that data they persuade investors to buy or sell the shares. They do not make use of sophisticated security analysis techniques such as valuation models. Further

in order to advise their clients on the expected performance of the companies, brokers will depend on their personal contacts with key personnel in the traded companies since the published information is not always timely and updated. Finally despite the fact that young, well trained and skilled brokers are needed to enhance the trading process, the existing brokers act as a monopoly and block the way to any new graduates wishing to enter this profession. Ghoniem (1992) reported that there was no increase in the number of brokers in the past five years and that only five brokers were enlisted in the last twenty years. Nevertheless we cannot ignore the fact that the salary given to new trainees is very low. According to Bishop (1986), it is difficult to develop more brokers and middlemen in Egypt because of the low compensation during training, future earnings perception and low production after qualification.

### **3. Suggested reforms**

To develop the brokerage profession so that it fits within the overall plan of enhancing the role of the stock market in Egypt, young, competent and capable graduates from economics and business administration departments should be encouraged to join the brokerage profession by offering them competitive salaries. Furthermore training courses should be provided to current as well as potential brokers. According to Bishop (1986), these courses should concentrate on modern valuation methods, the importance of capital gains versus dividend as well as the basic techniques of salesmanship such as prospecting, presentation, product knowledge and closing.



He also suggested that part of the exchange fees should be allocated for the education and compensation of future brokers. Moreover brokers should be given on the job training abroad which will certainly enhance their skills. Finally the current monopoly system of brokers can be reduced if 50% of the stock exchange board are institutional investors.

As for the market maker job, it could be undertaken by the current and newly formed foreign financial institutions since they have the financial as well as the technical capability. Market making could be limited in the beginning to the actively traded companies on the exchanges as well as the companies that the government intends to privatise through the stock market. Most reformed continental European exchanges have introduced market making by targeting active stocks first, to build up expertise and confidence in the segmented market.

#### **E. Information Availability:**

##### **1. Importance of information in efficient markets**

Accurate, timely and updated information is one of the essential factors in an efficient capital market. In such a market security prices are said to be fair as they reflect all available information (strong form efficiency) or all publicly available information (semi-strong form efficiency).

On the other hand in an inefficient market one would doubt that security prices reflect all available information. Investors cannot be confident that insiders will not exploit their ignorance and cause them loss.

Thus if an equity market is to develop for long term investment, as opposed to the speculation characterising many

emerging markets, it is imperative that listed companies be willing regularly to disclose financial and operating information, to enable shareholders to analyze and compare their prospects.

## **2. Availability of information in Egypt**

Concerning the available information about listed companies on Cairo Stock Exchange, one will observe that not all the listed companies publish their annual accounts as required by the law. Failure to comply with the information disclosure law subjects the companies to payment of fines that could reach a maximum of L.E. 1000. Nevertheless the payment of fines did not prove to be an effective enforcement measure since still a lot of companies do not publish their annual reports, Mahrous (Interview, January 1991). Even when companies decide to comply with the law, their published financial statements are either incomplete or summarized. In other instances the companies might publish their accounts very late, so that effective investment decision making is impossible.

Other than the financial accounts published by the listed companies, there is the daily journal published by the Stock Exchange which has the following information: number of issued shares, par value, currency, type of sector, date of issue, latest dividends, closing market price and the names and addresses of the brokerage firms.

In Egypt there are no specialized investment services like those provided by Standard & Poor, Value Line Investment Survey and the Financial Times. Hence comprehensive information about the traded companies (in terms of the type of business, capital



structure, key financial ratios, management team, share price data, expected earnings, beta rating) is entirely non existent. As mentioned in the previous chapter, there is no one responsible for the computation of a stock index, despite its being one of the most important indicators in any stock market. Also in Egypt there are no securities analysts per se. The securities analyst main task is to answer the following question: What are the primary influences that will determine the dividends to be paid on a stock and what will be the stock price in the future? To answer such a question, the analyst has to thoroughly examine the overall conditions in the country i.e. political, technological, social, economic etc.. as well as the industry in which the company operates within i.e. main competitors, growth prospects, laws affecting industry etc.. Finally the analyst analyzes the specific circumstances that pertain to the company under study.

The only current security analysis is found in Al Ahram Al Iktisadi, a weekly economic magazine that has a section that evaluates the past performance of some actively traded companies as well as their recent price movements.

### **3. Suggested reforms**

In order to reform the present situation, regulatory reform and enforcement should make listed companies on the exchanges publish their detailed accounts on time. Financial statements should be based on uniform accounting principles and reported by reliable and professionally competent auditors independent of the companies. This necessitates that Generally Accepted Accounting Principles are adopted by Egyptian

accountants. Further a professional association of accountants should be in charge of training, testing and licensing accountants in order to increase the number of qualified accountants.

The information provided by securities analysts is crucial given the difficulty of providing such information through the current brokers. The important question is the entity that should be in charge of this task. One can suggest that underwriters as well as some professional consultancy firms in Egypt could specialize in this service for a given fee. Nevertheless in the short run the brokers should at least conduct some analysis for the actively traded companies. It should be indicated that brokers in Alexandria Stock Exchange issue concise leaflets about the actively traded companies. They started this exercise since 1988, which is not done by brokers on Cairo Stock Exchange.

Finally the writer thinks that before privatising five star hotels through the stock market, there must be a broad and extensive dissemination of information by the financial advisors that will be responsible for handling these privatisations.

#### **F. Regulatory structure:**

##### **1. SEM and CMA in charge of regulations in Egypt**

Investor protection and the integrity of public information are underpinned by a regulatory framework and structure. In Egypt there is a tension between the traditional self-regulation of the exchanges, by the stock exchange members i.e. SEM and the reform programme proposed by the Capital



Market Authority i.e. CMA.

## **2. Role of the CMA**

In December 1979, a Presidential Decree was issued for the establishment of the CMA whose main objectives were declared as follows:

a. To create, develop and support an adequate climate for savings and investment needed for economic development.

b. To promote the development of primary and secondary markets for new and existing issues of securities.

c. To promote the expansion of securities intermediation.

d. To provide studies and recommendations for other governmental agencies for modification of existing legislation and new laws necessary for the development of the capital market.

e. To supervise the existence and availability of accurate, adequate, and sufficient data on securities, issuers and intermediaries.

f. To ensure that any public offering will be preceded by proper and accurate disclosure of information required by the investing public.

g. To supervise the stock exchange in order to prevent any form of deceit, fraud or unlawful speculation in transactions.

## **3. Conflict between CMA and SEA**

Though the aim of the CMA was to enhance the capital market, its objectives were defined in a broad and general manner. In addition the fact that these regulations have been issued in

the form of a Presidential Decree rather than a law, has failed to attribute to the CMA the legal authority and status necessary for the attainment of its objectives. Thus the CMA has no power over the Stock Exchanges which are supervised by a Government Commissioner as we mentioned previously. Since the CMA does not have any authority by law, its role was regarded as advisory by other governmental agencies. Its main task through the past decade was to try to issue laws and assert its influence. But, according to Henawi (1992), the only law which the CMA has issued was Law 146/1988 to regulate the activities of the Islamic Investment Companies, which ironically effected their liquidation. He added that this law has curbed investment rather than promoted it and no company was established as a result.

By definition the CMA was supposed to enhance the overall capital market operations and provide the necessary aid for the SEM to perform their task in a better way. On the contrary in practice there is lack of coordination and cooperation between both entities. The CMA are frustrated that they do not have direct control over the stock exchanges whereas the SEM regard the CMA as unqualified technically even for the regulatory role. Therefore we end up by having the CMA as an institution that is supposed to help the functioning of the stock market but in reality its main concern is to first establish a status for itself with regard to other agencies.

#### **4. Reform of the regulatory environment**

The CMA has asserted its role by promulgating a new regulatory structure for Egyptian stock exchanges: the Capital



Market Law. Based largely on critical analysis of the existing position commissioned from Bishop **"Summary of recommendations to the CMA Report in September 1986"**, the proposals follow his principal criticisms of the exchanges' weaknesses. Bishop (1986) cited the problems of: monopoly power of brokers over exchange decisions, low liquidity, poor pricing, inadequate available information, inappropriate commission system, costly, lengthy and antiquated trading/settlement systems, tax distortions, exchange revenues dependent entirely on listing fees and inadequate valuation data. Further he noted the alarming growth of the off-exchange dealing activity.

Accordingly the authorities response embodied in the Capital Market Law aims to: end brokers' monopoly by having 50% of the membership of the exchange board from financial institutions, encourage financial institutions to participate in market making to create market liquidity and allow the true worth of shares prices to be reflected. Further companies are to provide updated and timely accounts to the CMA while brokerage commission rates are to be amended upwards. In addition existing high and unjustifiable taxes (1.2% stamp duty tax, general revenue tax and 50% dividends tax) on share investment are to be eliminated while improvements to the present stock transfer system are to be introduced. The daily publication by the stock exchange should include only traded companies while P/E ratios and asset growth ratios should replace par value and dividend rates as primary valuation considerations and finally end off-exchange dealing.

### **Residual criticism of the proposed capital market law:**

There remains considerable dispute about the detail and the desirability of the proposed capital market law:

- It duplicates the task performed by the Companies Department in the establishment of public limited companies.
- It specifies that the companies that are listed on the official list should at least have 50% of their shares offered to the public which contradicts with the existing Companies Law that allows joint stock companies to be listed once 49% of their shares are offered to the public.
- Though it exempts the stocks and bonds listed on the official list from stamp duties and general revenue taxes, Sharf El Din (1992) argued that investors still have to pay a 50% tax on the dividends which is prohibitive to share investment.
- Though it allows for the establishment of underwriters, clearing agencies, mutual funds and unit trusts, Salman (1992) mentioned that there should be no separation between the management and ownership in investment trusts and mutual funds companies. He explained that this will act as a disincentive for the foreign financial institutions to invest in Egypt because they will not accept other people managing their funds, given their expertise in this field.
- Though the new law abolished the OTC trading, Saad (1992) argued that if the regulated markets fail, the OTC will not be readily subsumed. He suggested that the law should have organised dealings in the OTC instead of cancelling it.
- Though the law introduces a new entity i.e. investor protection group to protect investors' rights, Abou Ali (1992)



argued that it allowed the Chairman of the CMA to override the decisions taken by the general assembly of a company in favour of 5% of the investors which is against democratic decision making.

- Though it reduces the brokers' monopoly through incorporating 50% of the financial institutions in the exchange board, it has allocated too much discretionary power to the Chairman of the CMA. Agwa (Amin, 1992) stated that the previous functions undertaken by brokers such as cancelling deals, discontinuing the trading of a company and setting price limits were given to the chairman of the CMA.

Some of these qualifications reflect the exchanges' anxiety that the CMA is encroaching upon its authority, without appreciating significant practical difficulties. In other respects, the critics identify potential risks, such as the attempt to deepen markets by banning OTC trading, which may not result in the growth of the regulated market. This could be depicted in the Italian authorities over-regulation of Milan's Mercatino "little market" in the early 1970's, destroying the emerging business in quotation for fast growing Italian firms, Anolli and Cesarini (1992).

In deciding on the level of regulation that should be incorporated in the proposed capital market law, Genesis (1991) mentioned: "Indiscriminate regulation of immature capital markets runs a severe risk of stunting their expansion and diminishing their usefulness to the economy. Legislation should concentrate on ensuring equity and openness in the domestic markets and not to seek to protect foreign institutional

investors from risks which they are probably better equipped to evaluate than the regulators". In short one can suggest that this should be the philosophy behind regulating the stock exchange in Egypt.

#### **G. Conclusion:**

In this chapter we discussed the fundamentals of an efficient stock market. They comprise: the existence of profitable and well known companies whose shares are frequently traded; interested, educated investors that have the necessary savings to invest in securities; development and encouragement of institutional investors such as mutual funds and unit trusts; skillful and professional market makers and brokers; accurate and updated information and finally the existing laws and regulations should concentrate on ensuring equity and openness in the stock market and thus legislators should avoid either over-regulation or weak regulation since both will undermine the trust of investors in the stock exchanges.



### Notes and References:

[1] As stated before once a company is listed on the exchange it enjoys tax holidays irrespective of its being closed or not. There would be an incentive to stimulate share trading if this incentive was limited only to the companies that are traded.

[2] This new practice has largely superceded the old, 'continental' European systems where exchange officials negotiated periodic clearing prices from brokers' orders.

- **Interview with Nazmi, N.** Stockbroker at Cairo Stock Exchange, January 1991.

- **Interview with Mahrous, A.** General Secretary at Cairo Stock Exchange, January 1991.

## **Chapter 9 Conclusion: Privatisation and the stock market in Egypt**

### **A. Introduction:**

The last chapter of the thesis integrates the two topics that were analyzed in earlier chapters i.e. privatisation and the stock market in Egypt. As the title of the thesis suggests there is a two way relationship between privatisation of five star hotels in Egypt and its stock market. The choice of five star hotels as prime candidates for privatisation through the stock market will be beneficial for the privatisation process as a whole and for the revival of the role of the stock market in Egypt. The chapter first starts by pointing out the interlink between privatisation and equity markets in general. Then the chapter will present the expected benefits out of privatising five star hotels in Egypt through the stock market. In the end the chapter will conclude by referring to the limitations of this thesis.

### **B. Relationship between privatisation and equity markets:**

Equity markets and privatisation are closely related to each other. Garrod (1992) pointed out that security markets can only become sophisticated and efficient if there is extensive choice and frequent trading, a wide choice of shares only becomes available after an extensive privatisation programme. However privatisation can only be successful if investors have confidence both in the shares as an investment and in their liquidity, which can only be assured in a fully functioning



securities market. In other words capital markets, of which stock markets are a part, are needed to finance privatisation, and privatisation is a necessary instrument to stimulate capital markets. Since there is usually a shortage of supply of stocks in developing countries, privatisation issues are a convenient way of stimulating supply in domestic equity markets. Thus Cavazzuti (1990) emphasized that the sale to private ownership of state owned share holdings could correct the dearth of securities in a capital market. Specifically such sales could contribute by: broadening the market, reducing the volatility of share prices, permitting the diversification of private portfolios and reducing the risks transferred to the stock market.

In chapter (2) it was established that privatisation and stock exchange development have supported each other in many developing countries settings. Oyhenart (1991) and Walters (1985) argued persuasively that given the characteristics appropriate for expansion of volume and capitalization, markets can be adapted to privatisation and vice versa. The process of raising funds for privatisation provides an opportunity to create missing financial structures and to embark on financial market reform.

In the case of Egypt, privatisation could be one of the tools for enhancing the stock market in Egypt. This is because in Egypt there already exist two long established stock exchanges, unlike other developing countries, and there is liquidity in the domestic market. The main objective, however, is to change savers into investors, which could be achieved if the necessary

prerequisites in the previous chapter were implemented by the government.

**C. Expected Benefits from privatising five star hotels through the stock market in Egypt:**

Five star hotels in Egypt are good candidates for privatisation through the stock market because of the following benefits:

**1. Benefits to investors and private companies**

One of the objectives of the privatisation programme in Egypt is to increase share ownership. This explains the efforts made by the government to introduce a new capital market law as well as its announcements that it will privatise some of its five star hotels through the stock market. Stock market development will be beneficial to both investors and private companies. The stock market can provide the necessary capital for private companies through cheaper public offerings. Investors will not only earn a higher rate of return (if the companies were profitable) than that on bank deposits but also enjoy capital gains. Finally investors will become share owners which can be promoted as an objective in itself. Jayasinghe (1990) commented that the Sri Lankan advertising campaign emphasized this point by posing the question to the public "Have you ever owned a state corporation?" The answer to this question was that "Privatisation will offer you a direct major share of the corporate cake."

**2. Five star hotels in Egypt are profitable**

The profitability of an SOE is obviously a key determinant of how easy or difficult its sale will be. In other words the financial condition of the SOE will determine to



whom, what method and at what price will it be sold for. The Jamaican Stock Exchange Report (1988) advised governments to sell one or two attractive assets in the beginning in order to create a demonstration effect and build momentum in the public arena for privatisation. Further Leeds (1988) asserted that Malaysia has selected the container terminal at Port Kelang as its first SOE to be privatised because it enjoyed widespread recognition and had a record of profitability. He argued that the first transaction must be successful in order to create a positive public impression of privatisation which will provide credibility for future privatisation efforts.

On the other hand Buxton (1991) pointed out that sometimes it was possible to turn loss making enterprises into profitable ones and then sell them through the stock exchange as was the case of British Airways. Therefore investors will acquire loss making but potentially viable enterprises if they anticipate that certain restructuring measures could turn their earning potential around as was previously confirmed by financial consultants that the writer interviewed.

Given the high earnings of five star hotels in Egypt, even when compared to other five star hotels abroad, besides their good earnings prospects, one expects them to be easily floated on the stock exchange with only minor restructuring required.

### **3. A suitable organizational form**

The current organizational form of the SOE will influence the ease or difficulty with which the transfer of ownership is effected. A public limited company whose shares are already being traded makes privatisation relatively simple, consisting

only of offering additional blocks of shares held by the government to the public through the stock exchange.

On the other hand an enterprise set as a public sector company cannot be privatised at its present form but must first be transformed into a stock corporation subject to the current company laws so that its shares can be offered to the private sector.

Five star hotels in Egypt are owned by three main public sector companies and these public companies have the required autonomy to sell part or all of their shares to the private sector. For example Misr Hotel Company, a public sector company that owns several hotels, is already partially privatised and 36% of its shares are owned by the private sector and are traded on Cairo Stock Exchange. Therefore the transfer of ownership will not be a problem for five star hotels in Egypt and will not require major legislative changes.

#### **4. Trading in an active sector**

The sector of operation of an SOE will shape key aspects of its privatisation. Thus in the privatisation of public utilities special arrangements have to be made before the privatisation takes place in order to ensure that the interests of the consumers are adequately safeguarded. The privatisation of British Telecom and British Gas were accompanied by the establishment of regulatory bodies i.e. OFTEL and OFGAS granting licenses to the new public limited companies and imposing certain price and quality obligations, (Vuylsteke, 1988).

Applying this to the five star hotels in Egypt, they are



neither public utilities nor strategic industries that necessitate the provision of certain protective measures. On the contrary five star hotels are already privately managed by international well known chains through management contracts and they lie within the tourism sector which enjoys more autonomy and less governmental control than other sectors in the economy, besides its high expected growth prospects. The only precaution to be considered is to ensure that the valuation of five star hotels reflect their true worth to avoid future public criticism.

#### **5. The local stock exchange can be used**

The level of the capital market in a country will determine whether certain privatisation methods can be applied or not. Five star hotels in Egypt can be privatised through the stock market even with its current limitations. This is because they will resolve one of the main problem which is lack of successful companies to be offered to investors. Nevertheless it would be much better if the prerequisites suggested for the stock market in the previous chapter were incorporated together with the privatisation process.

#### **6. Hotel privatisation will not involve wider socio-political factors**

The decision to privatise SOEs is not wholly pragmatic as theory may indicate, but rather it will be greatly affected by the political nature of the topic, the role of ideology and the influence of power groups within the country. One of the most political and social issues that is involved in privatisation is the lay off of employees. In such case appropriate remedial mechanisms may need to be developed. Also

the government's concern over the concentration of ownership, whether local or foreign, will lead to the adoption of mechanisms that ensures wide spread ownership. Finally the opposition of certain groups that benefited from the public sector need to be dealt with through making use of well designed and large scale information campaigns explaining the advantages of the proposed privatisation.

Concerning five star hotels in Egypt, one can infer that they are not going to face strong political and social opposition since they do not concern the great population at large like other industries. Therefore Vuylsteke (1988) stated that five star hotels in Egypt will be the first to be privatised since they will face no political difficulties.

Already two hotels have been sold: the Meridien Cairo and Sheraton Hurghada by trade sales, with little opposition. The main concern was the price paid for those hotels, which echoes the debate within the U.K. and France on the question of underpricing of early privatisations issues.

In terms of labour shedding, overstaffing does not pose a serious problem for five star hotels in general as observed in the valuation of three five star hotels in chapter (6). However in some cases management may need to lay off some of the employees to improve the hotel's profitability. In this case, attractive compensation packages should be provided for the redundant employees.

#### **7. Promotion of wider share ownership**

The main advantage of a public offering of five star hotels is that it will permit wider share ownership since



savers beside current investors will be more than willing to invest in successful enterprises that yield higher returns compared to the existing alternative investment instruments. In Al Ahram newspaper on 13/4/1990, the Minister of Tourism announced that the expected rate of return on five star hotels which will be privatised through the stock market will range between 20-40%. Furthermore the protests by financial institutions that there are not enough successful companies in which they can invest their extra liquidity will be alleviated through the public offering of five star hotels. Although inevitably efficient management of risk will eventually require a larger number of eligible investments.

The public offerings of five star hotels can be easily oversubscribed given the expected high demand of private investors and financial institutions as well as foreign investors.

In addition privatising five star hotels through the stock market through making use of a well designed and creative campaign will help inform and educate the public about share investment, the stock exchange, its operations and its role in the economy. Further the campaign will not only explain the objectives of privatisation and the economic benefits that would accrue from it but also provide information about the SOE to be privatised through the stock market to build up its image and promote the sale of its shares.

Privatisation could be promoted in the various media (T.V., press, magazines) as indicated by De Mel (1988), Grimestone (1988), The Jamaican Stock Exchange Report (1988), Leeds (1988)

and Vuylsteke (1988). Also the Egyptian government could make use of the successful techniques utilized by other countries such as U.K., Jamaica, Turkey, Malaysia in their privatisation campaigns. In short a carefully planned and well designed campaign should result in a direct, simple, informative and attractive message to the Egyptian layman that counteracts the disputes about privatisation and enhances its benefits.

The above will not only benefit future privatisations of other SOEs but also the private companies which need to raise capital through the stock exchange.

Further advantages can be derived from privatising five star hotels through the stock market when this is accompanied by a full disclosure of information. This will provide openness and transparency to the privatisation process which is a feature not found in private deals. This is of the utmost importance in the early stages of the Egyptian privatisation programme and will help make privatisation politically more acceptable. Finally through privatising profitable hotels via the stock market, the privatisation process will gain momentum and the benefits that could be gained from privatisation i.e. a high return on investment could be conceived by the investing public. This will in turn enhance the image of privatisation in the eyes of the public and change their reluctant behaviour towards it.

Consequently one can expect future privatisations through public offerings of shares to be easier because not only would the public be familiar with privatisation through the stock market but also actors on the stock market would have gained



more experience in handling previous privatisation issues. As pointed out by Gultekin (1990), in the beginning, privatisation in Turkey was new to everyone in the country and therefore everyone had to learn through the process of privatisation itself. However he argued that as time passes by, one expects financial markets to be expandable and that selling hundreds of millions of dollars worth of shares in Turkish capital markets will occur sooner than anyone would think possible. The writer believes that this could be also true for Egypt.

#### **D. Limitations of the thesis:**

In the end it should be pointed out that this thesis has effected for the first time two technical exercises for Egypt: the valuation of three hotels and analysis of stock market indices. Practically speaking valuation is done by few consultant firms in Egypt but it has never been done for research purposes before.

In any research there must be certain limitations which are hereafter summarized:

1. The valuation exercise was limited to one sector which is the hotel industry because of the availability of financial statements that conformed with standard accounting principles, (Five star hotels in Egypt follow the U.S. uniform system of accounting) and the ease of conducting interviews with consultants who were performing the same valuation exercise. Valuation was concluded for three hotels i.e. Cairo Sheraton, Cairo Marriott and Aswan Oberoi. The writer did not choose the sample but was given their financial statements from the Information Centre at the Prime Minister's Cabinet.

2. The writer did not interview management which of course would have enhanced the quality of the valuation. However this was not possible because those hotels were at that time being valued by foreign and Egyptian firms. In addition since valuation is a politically sensitive area and the valuation of those hotels were not yet officially published, management did not agree to be interviewed. Even the consultants interviewed in Egypt and abroad were reluctant to answer certain questions, either due to confidentiality or the fact that they considered it professional information that is only provided for clients, in return for fees.

3. The writer used earnings valuation methods. Thus no asset valuation was computed for the three hotels which is necessary in this type of business. However such an exercise is beyond the scope of this thesis since it requires real estate or engineering firms to conduct it.

4. Concerning the calculation of the discount rate, certain assumptions were made, such as a riskless rate of 18% which is the rate on treasury bills. Although the correct rate should be on treasury bonds, this could not be employed because there is no active bond market in Egypt. Also the assumed risk premium was 3-4% which is low if compared to the risk premium used in developed markets i.e. 8-9%. Nevertheless having a low risk premium was compensated by having a high riskless return. Finally the beta of the hotel industry was assumed to be 1.00, the same as the market risk, which is higher than that for hotels abroad i.e. 0.4-0.6. This of course led to a higher discount rate of 16-18%. To solve for this problem, we made use



of a sensitivity matrix in order to display the impact of several variables on the determination of the NPV.

5. Concerning the calculation of the Cairo All Share Index and Tourism Index, the following assumptions were made:

- \* All companies were included and no company was excluded irrespective of its not being traded for a long period.
- \* Indexes were calculated for two years 1989 and 1990.
- \* Indexes were created for all currencies i.e. not for every currency separately.
- \* No sectoral indexes were calculated, except for the tourism sector.
- \* Indexes were price weighted based on the system in the Financial Times Actuaries Index, with no dividends adjustment.
- \* No attempt was made to calculate beta for hotels from the stock market data.

6. The thesis concentrated only on the stock market route as a viable medium for privatising five star hotels in Egypt in order to revive the role of its stock market. This of course does not rule out that other methods for privatising five star hotels such as private deals, management buyouts and employee share ownership could be utilized. However these other methods were not examined, in order to focus the analysis on the role of the Egyptian stock exchanges in privatisation; which evidence from a wide range of economies suggests is feasible for a developing economy.

7. The writer is aware of the fact that privatisation has been applied in a lot of countries and in several ways. Though the thesis referred to several developing countries experiences with privatisation, the main bulk of the thesis concentrated on the Egyptian context.

TABLE (2.1)  
1980-1989

Year	Proceeds (Million sterling)
1979-1980	377
1980-1981	210
1982-1983	455
1983-1984	1139
1984-1985	2050
1985-1986	2707
1986-1987	4460
1987-1988	5140
. 1989	3580

Source: HM Treasury 1990.



TABLE (2.2)  
Main Methods of Sale in UK Privatisations  
1980-1988

Name of company	Date	Proceeds million Sterling	Shares Million	Subscription Times
1. Offer for sale				
Amersham International	1982	63.0	N/A	25.6
Associated British Ports	1983	48.1	19.6	33.0
British Aerospace	1981	150.0	100.0	3.5
British Aerospace	1985	551.0	146.9	12.0
British Airports Authority	1987	919.0	375.0	8.0
British Airways	1987	900.0	1.0	32.0
British Petroleum	1979	290.0	N/A	1.5
British Gas	1986	5603.0	4000.0	4.0
British Telecom	1984	3916.0	3000.0	9.7
Britoil	1985	450.0	N/A	10.0
Cable & Wireless	1981	224.0	133.3	5.6
Cable & Wireless	1985	602.0	102.5	2.0
Jaguar	1984	294.0	N/A	8.3
Rolls Royce	1987	1360.0	801.0	9.4
TSB	1986	1360.0	1500.0	8.0
2. Tender Offer				
Associated British Ports	1984	52.4	19.4	1.6
British Airports Authority	1987	362.0	125.0	6.0
British Petroleum	1983	565.0	N/A	2.7
Britoil	1982	548.0	70% left with underwriters	
Cable & Wireless	1983	275.0	23% left with underwriters	
Enterprise Oil	1984	393.0	Left with underwriters	
3. Mgmt/Employee Buyouts				
Brooke Marine Ltd.	1986	0.1		
DAB	1987	7.0		
Leyland Bus	1987	40.0		
Istel	1987	26.0		
National Freight Company	1982	7.0		
Swan Hunter Shipbuilders Ltd	1986	5.0		
Unipart	1987	30.0		
Vickers Shipbuilding Ltd.	1985	42.0		
Vosper Thornycroft Ltd.	1985	18.5		
4. Private sale				
British Airways Helicopters	1986	13.5		
British Rail Hotels	1983	45.0		
British Sugar Plc	1986	425.0		
Hall Russel Ltd.	1984	3.0		
INMOS	1984	95.0		
International Aeradio	1983	60.0		
Royal Ordnance	1986	190.0		
Sea Link	1984	66.0		
Shorts Brothers	1989	30.0		
Wytch Farm	1984	82.0		

Source: HM Treasury 1990 and Vickers and Yarrow 1988.

Table (2.3)  
Privatisation in developing countries

Name	Type/Nature	Method	Problem/Success	Future planned privatisations
<b>A. Asia:</b>				
1. Taiwan	19 small SOEs * China Steel	Public offering Public offering	- Volatile stock market - Only 200 investors came up with cash though the offer originally attracted 3.2 million investors	
2. Thailand	Commercial SOEs * Krug Thai Bank	Public offering Public offering	- Union opposition - Resistance of bureaucracy - Failed due to being overpriced and it had a long history of poor performance	Airlines (public offering) Electricity (public offering) Aluminum Co. (joint venture) Hotel (private sale)
3. Philippines	500 SOEs  * 5 small SOEs concluded	Sale of assets (not concluded)  private sales	- Did not devote time to programme - Opposition of bureaucrats - SOEs have high debt ratios	
4. Malaysia	* Port Kelang Airline Int. Shipping General Hospital Water supply	public offering public offering public offering Private sale Mgmt contract	- Labour shedding - Getting SOEs ready - SOEs had high debt ratios - Port Kelang was a successful case: profitable, recognized by public and not in a political sensitive area	Telecom (public offering) Port Penang (public offering)
5. New Zealand	SOEs	Direct sale to foreigners	- Politically sensitive decision that not all countries can pursue.	Airline (public offering) Finance Co. (Public offering)
6. South Korea	11 commercial successful SOEs	Public offering	- popular capitalism was advocated - Electric power attracted 6 million investors and accounted for 13% of the exchange's capitalization	Banks (public offering) Research (public offering) Power (public offering) Telecom (public offering)
7. Sri Lanka	Airline Textile Tile Factories	Mgmt contract Mgmt contract Private sales	- Lack of political determination - Slow legal amendment - Lack of strong capital market - Labour shedding	- Telecom (joint venture) - Trading Co. (private sale) - Chemicals (private sale) - Rubber (private sale)
8. Indonesia	200 Losing SOEs  * Tyre making Co.	Private sale	- Labour shedding - Loss making SOEs - Tyre making Co. is the first to be sold	- Airline (partial sale) - Shipping (partial sale)
<b>B. Latin America:</b>				
9. Chile	400 SOEs	Public offering Debt/equity Employee buyout Mgmt buyout Private sale	- Heavy promotion of sale of SOEs through the stock market - Carefully screening buyers - Encouraging foreign institutions to buy	- Gold mine (lease) - Electricity (private sale) - Power (public offering) - Postery (private sale)
10. Mexico	270 SOEs Commercial SOEs	Liquidations Private sale	- Regulatory framework is not ready - Wealth is highly concentrated - Stock exchange is narrow	- Airline (private sale) - Steel (Private sale) - Hotel chain (private sale)



Name	Type/Nature	Method	Problem/Success	Future planned privatisations
11. Jamaica	* NCB * CCC Hotels Food Chemicals Sugar	Public offering Public offering Private sale Private sale Private sale Mgmt contract	- NCB and CCC privatisations were both successful and boosted the stock exchange Both were profitable companies and Jamaica used good marketing techniques to promote the stock market. Both issues helped in building momentum for privatisation.	- Petroleum (public offering) - Foundry (public offering) - Shipping (private sale) - Manufacturing (private sale) - Hotel (lease)
12. Argentina	40 SOEs	Private sale	- Labour shedding - Union pressure - Administrative delays	- Steel (public offering) - Petrochemicals (public offerir - Oil Co. (sale of assets)
C. Africa:				
13. Togo	Hotels Textile Dairy Oil refinery Steel mills	Mgmt contract Sale of assets Leases Leases Leases	- Not enough liquidity in local market - No regulatory framework was prepared - Quick deals that were criticized: being economically and financially unfavourable - High degree of protection provided to the privatised companies	- Airline (private sale) - Timber (mgmt contract) - Bank (mgmt contract) - Fishing (mgmt contract) - Bus operation (private sale) - Salt mining (sale of assets)
14. Mozambique	300 SOEs 25 small SOEs	Studied Private sale	- Reviewing SOEs in order to decide if they will be sold, liquidated or restructured.	- Agriculture estates leases or joint venture
D. Eastern Europe:				
15. Czechoslovakia	Small SOEs Light Industry Heavy Industry (Under-study)	Given to owners Voucher system Retained	- Valuation is a problem - Private savings represent 10% of the book value of the state assets - Savings concentrated in the hands of 5% of the population	- Mass privatisation through voucher distribution system is understudy
16. Hungary	Commercial SOEs	Private sale to foreigners	- Capital market is limited - Large SOEs have high debt ratios - Problems associated with deregulation - Western investors bought viable enterprises	
17. Poland	540 small SOEs  * Large SOEs (Not concluded)	Liquidations  Public offerings	- No financial intermediation - No business and mgmt skills - Ownership of state companies undecided - Valuation problem - Failed to sell large SOEs through Warsaw Stock Market because share prices went down	
18. Russia			- Valuation problem - Costly restructuring - No bankruptcy law - No competition	- Mass privatisation through voucher distribution system is under-study
19. Romania			- Single SOE responsible of 90% of the industrial production - Need time to educate people about privatisation	- 30% shares given freely to citizens - 70% shares remain with a state ownership fund (Under study)
20. East Germany	15,000 small businesses	Sale of assets	- Costly restructuring - Labour shedding	

Sources: Boulton (1992), Bobinski (1992), Candoy-Sekse (1988), Denton (1992), Genillard (1992), Lee and Nellis (1991) Mejstrik (1991), Marsh (1992), Nanaki (1988,1990), Parkes (1992), Pollock (1990), Shoreham (1990), Staibus (1990), Valentiny (1991) and Wilson (1991).

Table (3.1)  
Overall Balances of NPEs  
as percentage of GDP

	1973	1977	1979	1980/81	1981/82	1982/83	1983/84
<b>1. Current Surplus or Deficit</b>							
Economic Authorities	3.06	2.83	3.82	10.66	5.87	6.15	5.59
Public companies	7.94	9.10	8.22	6.12	3.77	3.85	3.88
Total	11.00	11.93	12.04	16.78	9.64	10.00	9.47
<b>2. Capital Expenditures</b>							
Economic Authorities	4.17	7.06	8.59	7.27	6.27	7.53	7.05
Public companies	10.73	15.28	13.25	13.27	12.39	11.30	10.81
Total	14.90	22.34	21.00	20.54	18.66	18.83	17.86
<b>3. Overall Surplus / Deficits</b>							
Economic Authorities	-1.11	-4.23	-4.77	3.39	-0.40	-1.38	-1.46
Public companies	-2.79	-6.18	-5.03	-7.15	-8.62	-7.45	-6.93
Total	-3.90	-10.41	-9.80	-3.76	-9.02	-8.83	-8.39

Source: CAPMAS, Ministry of Finance, World Bank



Table (3.2)  
Overall Balances of Economic Authorities  
Excluding Petroleum and Suez Canal  
as percentage of GDP

	1973	1977	1979	1980/81	1981/82	1982/83	1983/84
Current Surplus/Deficit	2.94	-1.59	-1.49	-1.56	-4.08	-1.24	-1.53
Expenditure	3.40	5.23	5.86	5.47	4.58	6.00	5.62
Overall Surplus/Deficit	-0.46	-6.82	-7.35	-7.03	-8.66	-7.24	-7.15

Source: Ministry of Finance and World Bank

Table (3.3)  
Budgetary Burden of NPEs  
as percentage of GDP

	1973	1977	1979	1980/81	1981/82	1982/83	1983/84
Public companies	1.20	4.17	6.35	6.17	4.48	4.70	4.13
Economic Authorities	2.51	2.10	2.42	-5.94	-0.23	2.07	1.40
Total Burden	3.71	6.27	8.77	0.23	4.25	6.77	5.53
National Fiscal Deficit	14.7	16.9	26.9	15.8	25.3	20.6	20.2
NPE Deficit as a % of National Fiscal Deficit	25.24	37.10	32.60	1.46	16.80	32.86	27.38

Negative burden indicates a positive impact on the budget

Source: CAPMAS, Ministry of Finance, World Bank



Table (3.4)  
Overall balances of Public Enterprises  
in selected developing countries  
as % of GDP at market prices

Country	1974/77	1978/80
Egypt	-9.8	-9.3
Turkey	-8.3	-9.7
India	-6.9	-6.8
Venezuela	-6.3	-5.9
Mali	-5.9	-2.7
Peru	-5.2	-1.8
Mexico	-4.9	-4.6
Jamaica	-4.5	-4.0
Bolivia	-4.5	N.A.
Argentina	-4.2	-3.4
Tanzania	-3.9	N.A.
Barbados	-2.8	-3.4
Bahamas	-2.7	-2.1
Malawi	-2.5	-3.5
Guatemala	-1.9	-2.7
Paraguay	-1.7	-1.0
Chile	-1.2	-0.7
Colombia	-1.2	-0.5
Uruguay	-0.3	-1.1
Portugal	N.A.	-12.6
Costa Rica	N.A.	-4.4
Honduras	N.A.	-2.3

N.A. = not available

Source: Robert Floyd et al, (1984), 'Public Enterprises in Mixed Economies', IMF : Washington, D.C.

Table (3.5)  
 Budgetary Burden of NPES in  
 selected developing countries  
 as a % of GDP at market prices

Country	1974/77	1978/80
India	5.2	5.5
Tanzania	5.0	N.A.
Egypt	4.8	5.7
Barbados	3.8	N.A.
Bahamas	3.0	2.0
Turkey	2.3	3.5
Venezuela	2.3	-0.6
Malawi	2.2	1.8
Mexico	2.1	2.9
Jamaica	1.9	3.9
Guatemala	1.5	1.9
Peru	1.0	0.4
Uruguay	0.5	0.6
Chile	0.2	-2.5
Colombia	0.2	0.3
Bolivia	-0.4	3.8
Portugal	N.A.	N.A.

A negative burden implies a positive impact on the budget

N.A. = not available

Source: Robert Floyd et al, (1984), 'Public Enterprises in Mixed Economies', IMF : Washington, D.C.



Table (3.6)  
Rates of return in SOEs  
(in percentage)

	1973	1977	1979	1980/81	1981/82	1982/83	1983/84
Net rate of return Book value capital	9.02	11.14	9.37	7.69	4.49	4.64	4.77
Net rate of return Revalued Capital	5.25	5.88	5.52	4.3	2.18	1.99	1.71

Source: CAPMAS and World Bank

Graph (3.1) D/E ratio for NPEs

(1973-1984)

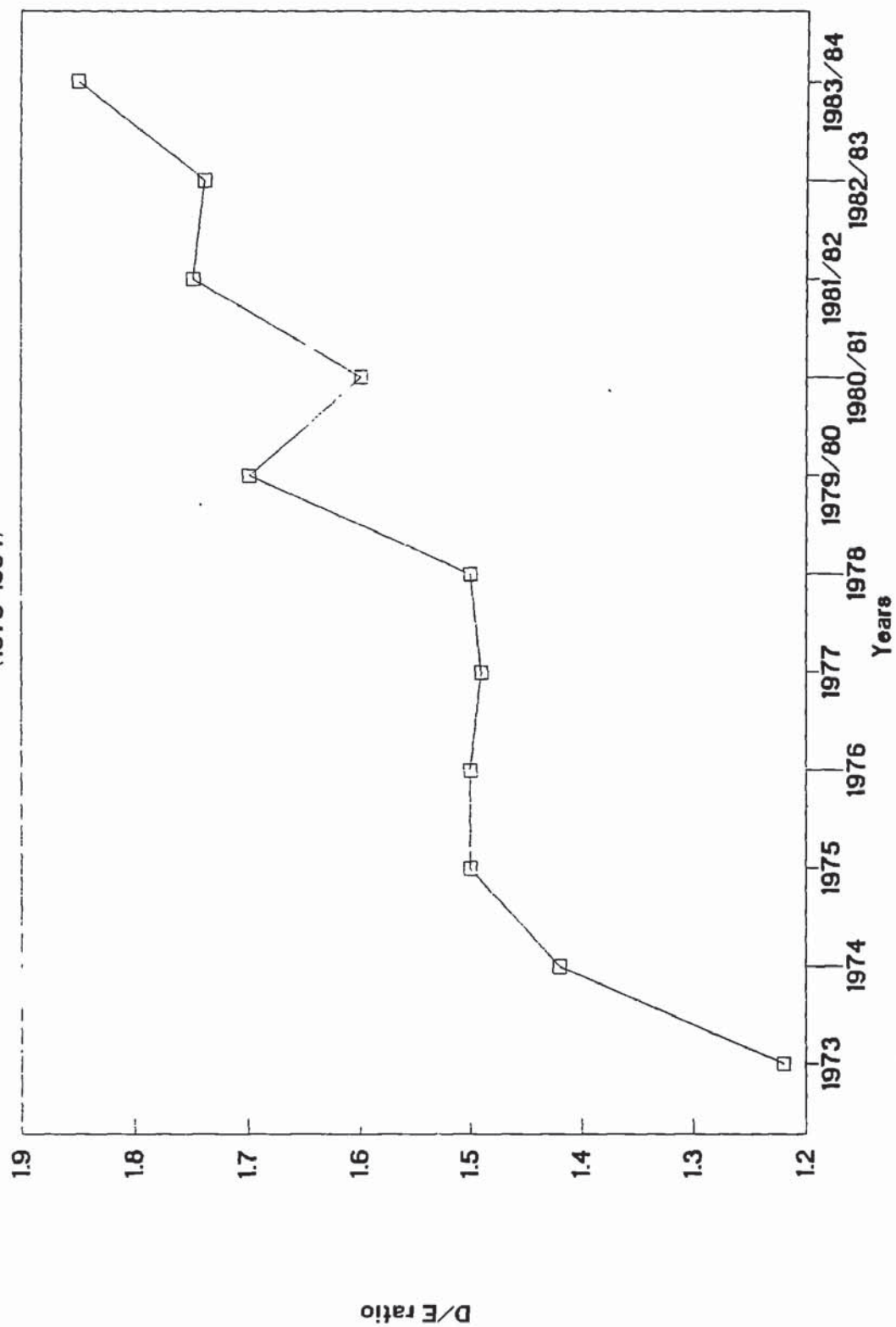




Table (3.7)  
The distribution of Public external debt  
as of June 30, 1985

Institution	\$ millions	%
Public enterprises	6029	35.41
Financial Institutions	1966	11.55
Government	8990	52.81
Private	39	0.23
	-----	-----
Total	17024	100.00

Source: World Bank

Table (3.8)  
Development of NPE Exports  
in million \$, current prices

	1974	1981/82	1984/85
1. Public Sector	4550	5356	5279
of which: Petroleum	187	3329	2891
: Suez Canal	N.A.	909	897
2. Private Sector	944	1266	1564

Exports: goods and non factor services  
Petroleum excludes foreign oil companies

Source: Central Bank of Egypt, World Bank



Table (3.9)  
Balance of Payment impact of NPES  
in billions \$

	ALL NPES	Excluding Oil and Suez Canal
Debt Service	1.4	1.2
Imports	5.1	4.5
Exports	5.3	1.5
Net Surplus/Deficit	-1.2	-4.2
Net impact as % of GDP	4	14

Source: World Bank

Diagram (3.1)  
Management Structure Levels  
Under Law 97/1983

General Authority (Organisation)  
Appointed by a decree from President

Chairman.

Five Chairmans of SOEs.

Four external experts.

A representative from Commercial  
Union.

State Owned Enterprise (SOE)  
Its BOD's consists of 7 or 11 members:

Chairman appointed by Prime Minister

Half of members appointed by Minister

Half of members elected from employees

Optional = two experts with non voting  
rights appointed by Minister.

General Assembly of a SOE

Chairman is the Minister  
or he appoints someone.

Representatives from four  
Ministries i.e. Finance,  
Economy, Planning and  
Foreign Trade.

Chairman and BOD's  
of General Authority.

Chairman and BOD's of SOE  
(No voting rights).

Four Employees from SOE  
who are not members of the  
BOD's.

Four external experts  
appointed by Minister.

A representative from the  
Central Power Authority  
(No voting right).



Diagram (3.2)

Management Structure Levels  
Under new Public Sector Law

BOD's of the Holding Companies:

- Chairman
- Four or Six competent and experienced members

General Assembly  
If SOE is fully owned by  
government:

Chairman of Holding Company.

Two experts appointed by Chairman.

BOD's of Holding company.

BOD of the SOE

Chairman (Expert and competent).

Half of BOD's appointed by the  
BOD of the holding company.

The other half are elected from the  
employess.

General Assembly  
In case of Joint Ventures:

Chairman of the Holding  
Company.

BOD of the Holding company.

Representatives from the  
Shareholders.

BOD of the SOE

Chairman (same).

Members appointed by  
BOD of holding company.

Members elected from  
Shareholders.

Members from the employees  
of the SOE.

BOD of holding companies is appointed for 3 years that could be renewed  
BOD of SOEs are appointed for 3 years that could be renewed  
The number of members of the BOD of a SOE could be 5 or 7 or 9  
Managing Director of a SOE is elected for 3 years that could be renewed

TABLE (4.1)

EGYPT'S BALANCE OF PAYMENT						L.E. Millions
Revenues Side	1985/86	1986/87	1987/88	1988/89	1989/90	OVERALL % CHANGE (1985/86-1989/90)
1. Receipts:						
Export Proceeds	2885.4	2706.9	3766.0	4712.1	5715.3	98.1
Shipping	581.1	833.4	701.1	1055.4	987.6	70.0
Suez Canal Dues	719.8	803.6	888.1	1437.3	1618.9	124.9
Tourism	424.3	837.0	1922.2	2303.8	2761.8	550.9
Interest & Dividends	610.9	1101.6	1111.9	1599.5	1657.5	171.3
Other Receipts	1125.8	2236.2	2435.9	3462.3	3859.7	242.8
2. Transfers:						
Official (Government)	355.2	1643.2	1544.5	1854.2	2492.1	601.6
Workers Remittances	3950.9	6713.4	7543.4	9196.4	9763.7	147.1
Total Revenues	10653.4	16875.3	19913.1	25621.0	28856.6	170.9
ANNUAL % CHANGE	1985/86	1986/87	1987/88	1988/89	1989/90	AVERAGE ANNUAL COMPOUND RATE (1986/87-1989/90)
1. Receipts:						
Export Proceeds	---	-6.2%	39.1%	25.1%	21.3%	19.8%
Shipping	---	43.4%	-15.9%	50.5%	-6.4%	17.9%
Suez Canal Dues	---	11.6%	10.5%	61.8%	12.6%	24.2%
Tourism	---	97.3%	129.7%	19.9%	19.9%	66.7%
Interest & Dividends	---	80.3%	0.9%	43.9%	3.6%	32.2%
Other Receipts	---	98.6%	8.9%	42.1%	11.5%	40.3%
2. Transfers:						
Official (Government)	---	362.6%	-6.0%	20.1%	34.4%	102.8%
Workers Remittances	---	69.9%	12.4%	21.9%	6.2%	27.6%
% WT to TOTAL REVENUE	1985/86	1986/87	1987/88	1988/89	1989/90	
1. Receipts:						
Export Proceeds	27.1	16.0	18.9	18.4	19.8	
Shipping	5.5	4.9	3.5	4.1	3.4	
Suez Canal Dues	6.8	4.8	4.5	5.6	5.6	
Tourism	4.0	5.0	9.7	9.0	9.6	
Interest & Dividends	5.7	6.5	5.6	6.2	5.7	
Other Receipts	10.6	13.3	12.2	13.5	13.4	
2. Transfers:						
Official (Government)	3.3	9.7	7.8	7.2	8.6	
Workers Remittances	37.1	39.8	37.9	35.9	33.8	
TOTAL REVENUES	100.0	100.0	100.0	100.0	100.0	

\* FISCAL YEAR 1985/86 = 1/7/1985-30/6/1986

SOURCE: CENTRAL BANK OF EGYPT



TABLE (4.2)

TOURISM REVENUES (L.E.)  
1985-1990

YEAR	TOURISM REVENUES	% CHANGE
1985	339000000	---
1986	311500000	-8.1%
1987	1265500000	306.3%
1988	1918000000	51.6%
1989	2359000000	23.0%
1990	2760000000	17.0%
OVERALL % CHANGE 1985-1990		= 714.2%
AVERAGE ANNUAL COMPOUND RATE 1986-1990		= 77.9%

SOURCE: EGYPTIAN TOURIST AUTHORITY

TABLE (4.3)

	NUMBER OF TOURISTS (ARRIVALS)											
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	TOTAL
JAN	72086	85529	84782	98812	111243	103258	97710	118210	152744	162558	210989	1297921
FEB	84585	102193	98127	99841	107457	114566	85499	108249	150028	155347	208376	1314268
MAR	102682	116479	119731	134170	128833	139407	101735	133967	181350	219816	238065	1616235
APR	102718	127909	122225	117696	144502	135043	102854	163022	165628	174172	240617	1596386
MAY	93128	108244	111911	122916	124930	123247	91361	132767	136384	167181	205794	1417863
JUN	116616	118992	115423	122632	118573	134312	118561	140747	143458	173012	227552	1529878
JUL	112000	152970	144331	167599	167426	154868	136360	204197	206267	266625	315287	2027930
AUG	135000	159747	153646	142286	144339	139704	134657	176153	172970	258297	269614	1886413
SEP	112930	124190	136847	132971	134969	130524	107075	162336	157296	218818	202001	1619957
OCT	117208	105735	120306	138984	146981	129715	114885	169668	176858	261169	179537	1661046
NOV	101574	91981	107551	108672	114925	105821	97777	132768	160770	211887	134681	1368407
DEC	102000	82058	108371	111353	116282	107961	122773	152869	165740	234516	167604	1471527
TOTAL	1252527	1376027	1423251	1497932	1560460	1518426	1311247	1794953	1969493	2503398	2600117	18807831
% CHANGE	---	9.9%	3.4%	5.2%	4.2%	-2.7%	-13.6%	36.9%	9.7%	27.1%	3.9%	

AVERAGE ANNUAL COMPOUND RATE FOR 1981-1990 = 8.4%

SOURCE: MINISTRY OF TOURISM



TABLE (4.4)

	NUMBER OF TOURIST NIGHTS											
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	TOTAL
JAN	571874	745423	736758	630217	677180	758348	710067	1526289	1330006	1583993	1873332	11143487
FEB	531447	722493	640387	618516	618322	672477	510647	1175852	1186207	1231695	1500664	9408707
MAR	506598	765973	714317	736697	750729	780973	616636	1346094	1328917	1469341	1722262	10738537
APR	580084	830489	828395	806069	770568	792326	634097	1487592	1418205	1393089	1588274	11129188
MAY	584156	746707	738610	699946	655890	759335	545714	1053287	1111290	1186581	1430803	9512319
JUN	632792	821678	790226	674555	507201	686690	587867	921355	987203	1005410	1290532	8905509
JUL	648000	866634	771132	829655	763229	885628	702530	1363420	1491932	1785166	1591900	11699226
AUG	960000	1169671	1006078	1035543	871078	935943	1025204	2039204	2917407	3467011	3036582	18463721
SEP	897223	1063538	899256	857768	841097	851225	738166	1698558	2117478	2646657	2398392	15009358
OCT	745052	924060	796913	704770	770908	672183	607363	1283259	1500021	1902511	1483707	11390747
NOV	789012	606386	696562	658612	675072	645774	616854	1067427	1295258	1536433	1071319	9658709
DEC	638000	542663	683256	604398	670927	566151	552221	899066	1180071	1374793	954921	8666467
TOTAL	8084238	9805715	9301890	8856746	8572201	9007053	7847366	15861403	17863995	20582680	19942688	135725975
% CHANGE	---	21.3%	-5.1%	-4.8%	-3.2%	5.1%	-12.9%	102.1%	12.6%	15.2%	-3.1%	

AVERAGE ANNUAL COMPOUND RATE FOR 1981-1990 = 12.7%

SOURCE: MINISTRY OF TOURISM

TABLE (4.5)

	AVERAGE LENGTH OF STAY (NIGHTS)											
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	AVERAGE
JAN	7.9	8.7	8.7	6.4	6.1	7.3	7.3	12.9	8.7	9.7	8.9	8.4
FEB	6.3	7.1	6.5	6.2	5.8	5.9	6.0	10.9	7.9	7.9	7.2	7.1
MAR	4.9	6.6	6.0	5.5	5.8	5.6	6.1	10.0	7.3	6.7	7.2	6.5
APR	5.6	6.5	6.8	6.8	5.3	5.9	6.2	9.1	8.6	8.0	6.6	6.9
MAY	6.3	6.9	6.6	5.7	5.3	6.2	6.0	7.9	8.1	7.1	7.0	6.6
JUN	5.4	6.9	6.8	5.5	4.3	5.1	5.0	6.5	6.9	5.8	5.7	5.8
JUL	5.8	5.7	5.3	5.0	4.6	5.7	5.2	6.7	7.2	6.7	5.0	5.7
AUG	7.1	7.3	6.5	7.3	6.0	6.7	7.6	11.6	16.9	13.4	11.3	9.2
SEP	7.9	8.6	6.6	6.5	6.2	6.5	6.9	10.5	13.5	12.1	11.9	8.8
OCT	6.4	8.7	6.6	5.1	5.2	5.2	5.3	7.6	8.5	7.3	8.3	6.7
NOV	7.8	6.6	6.5	6.1	5.9	6.1	6.3	8.0	8.1	7.3	8.0	7.0
DEC	6.3	6.6	6.3	5.4	5.8	5.2	4.5	5.9	7.1	5.9	5.7	5.9
AVERAGE	6.48	7.18	6.61	5.95	5.52	5.95	6.01	8.97	9.06	8.16	7.72	7.05
% CHANGE	---	10.9%	-8.0%	-10.0%	-7.2%	7.8%	1.0%	49.2%	1.0%	-10.0%	-5.3%	

AVERAGE ANNUAL COMPOUND RATE FOR 1981-1990 = 2.9%

SOURCE: MINISTRY OF TOURISM



TABLE (4.6)

NUMBER OF TOURISTS BY NATIONALITY  
1986-1990

YEAR	ARABS	O.E.C.D	SOCALIST	OTHERS	TOTAL
1986	554181	619251	33410	104408	1311250
1987	657006	927642	43212	167095	1794955
1988	659749	1097834	51512	160398	1969493
1989	952209	1266100	50117	234972	2503398
1990	1140231	1214238	57334	188332	2600135
MEAN	792675	1025013	47117	171041	2035846

OVERALL % CHANGE (1986-1990)

105.8%      96.1%      71.6%      80.4%      98.3%

FIGURES '000      TOURIST NIGHTS BY NATIONALITY  
1986-1990

YEAR	ARABS	O.E.C.D	SOCALIST	OTHERS	TOTAL
1986	3722	3583	95	448	7848
1987	7671	6567	245	1378	15861
1988	7643	8584	307	1330	17864
1989	9645	9174	319	1445	20583
1990	9600	8630	365	1347	19942
MEAN	7656	7308	266	1190	16420

OVERALL % CHANGE (1986-1990)

157.9%      140.9%      284.2%      200.7%      154.1%

AVERAGE LENGTH OF STAY  
1986-1990

YEAR	ARABS	OECD	SOCALIST	OTHERS	TOTAL
1986	6.7	5.8	2.9	4.3	6.0
1987	11.7	7.1	5.7	8.2	8.8
1988	11.6	7.8	6.1	8.3	9.1
1989	10.1	7.2	6.4	6.1	8.2
1990	8.4	7.1	6.4	7.1	7.7
MEAN	9.7	7.0	5.5	6.8	8.0

OVERALL % CHANGE (1986-1990)

25.4%      22.4%      120.7%      65.1%      28.3%

SOURCE: EGYPTIAN TOURIST AUTHORITY

TABLE (4.7)  
ESTIMATED TOURISTS & TOURIST NIGHTS TO EGYPT

YEAR	TOURISTS	TOURIST NIGHTS
1990	2600117	19942688
1991	2818527	22475409
1992	3055283	25329786
1993	3311927	28546669
1994	3590129	32172096
1995	3891700	36257952
1996	4218602	40862712
1997	4572965	46052277
1998	4957094	51900916
1999	5373490	58492332
2000	5824863	65920859

A growth rate of 8.4% was applied to the tourists 1990 figures

A growth rate of 12.7% was applied to the tourist nights 1990 figures



TABLE (4.8)  
AVERAGE SPENDING PER NIGHT

YEAR	TOURISM REVENUES	TOURIST NIGHTS	AVERAGE SPENDING L.E.	% CHANGE
1985	339000000	9007053	37.6	---
1986	311500000	7847366	39.7	5.5%
1987	1265500000	15861403	79.8	101.0%
1988	1918000000	17863995	107.4	34.6%
1989	2359000000	20582680	114.6	6.7%
1990	2760000000	19942688	138.4	20.8%

AVERAGE ANNUAL COMPOUND RATE (1985-1990) = 28.1%%

TABLE (4.9)

ESTIMATED AVERAGE SPENDING PER NIGHT  
1991-2000

YEAR	AVERAGE SPENDING L.E.	AVERAGE SPENDING \$
1990	138.4	41.9
1991	166.1	50.3
1992	199.3	60.4
1993	239.2	72.5
1994	287.0	87.0
1995	344.4	104.4
1996	413.3	125.2
1997	495.9	150.3
1998	595.1	180.3
1999	714.1	216.4
2000	856.9	259.7

\* Exchange rate on March 1992 was 1\$ = 3.3 L.E.

\* A growth rate of 20% was applied to 1990 average spending figure.  
It is a weighted average  $(28.1 \times 0.4 + 15 \times 0.6) = 20.24\%$ .



TABLE (4.10)  
HOTEL CAPACITY GROUPED BY REGION  
1985-1989

NUMBER OF HOTELS						
REGION	1985	1986	1987	1988	1989	OVERALL % CHANGE 1985-89
CAIRO	127	130	135	138	143	12.6%
ALEX	51	57	57	62	59	15.7%
LUXOR	19	24	25	26	31	63.2%
ASWAN	16	16	16	19	20	25.0%
OTHERS	87	88	97	115	150	72.4%
TOTAL	300	315	330	360	403	34.3%

	ANNUAL % CHANGE					AVERAGE ANNUAL COMPOUND RATE 1986-90
	1985	1986	1987	1988	1989	
CAIRO	---	2.4%	3.8%	2.2%	3.6%	3.0%
ALEX	---	11.8%	0.0%	8.8%	-4.8%	3.9%
LUXOR	---	26.3%	4.2%	4.0%	19.2%	13.4%
ASWAN	---	0.0%	0.0%	18.8%	5.3%	6.0%
OTHERS	---	1.1%	10.2%	18.6%	30.4%	15.1%

	% WEIGHT TO TOTAL				
	1985	1986	1987	1988	1989
CAIRO	42.3%	41.3%	40.9%	38.3%	35.5%
ALEX	17.0%	18.1%	17.3%	17.2%	14.6%
LUXOR	6.3%	7.6%	7.6%	7.2%	7.7%
ASWAN	5.3%	5.1%	4.8%	5.3%	5.0%
OTHERS	29.0%	27.9%	29.4%	31.9%	37.2%
	100%	100%	100%	100%	100%

SOURCE: EGYPTIAN TOURIST AUTHORITY

TABLE (4.11)  
HOTELS GROUPED BY CATEGORY  
1985-1989

NUMBER OF HOTELS					
	1985	1986	1987	1988	OVERALL 1989 % CHANGE 1985-89
DE LUXE	22	26	28	30	34 54.5%
FIRST	106	109	115	127	152 43.4%
SECOND	155	156	162	166	188 21.3%
UNCLASSIFIED	19	24	25	37	29 52.6%
TOTAL	302	315	330	360	403 33.4%
% ANNUAL CHANGE					
	1985	1986	1987	1988	AVERAGE ANNUAL 1989 COMPOUND RATE 1985-89
DE LUXE	---	18.2%	7.7%	7.1%	13.3% 11.6%
FIRST	---	2.8%	5.5%	10.4%	19.7% 9.6%
SECOND	---	0.6%	3.8%	2.5%	13.3% 5.1%
UNCLASSIFIED	---	26.3%	4.2%	48.0%	-21.6% 14.2%
% WEIGHT TO TOTAL					
	1985	1986	1987	1988	1989
DE LUXE	7.3%	8.3%	8.5%	8.3%	8.4%
FIRST	35.1%	34.6%	34.8%	35.3%	37.7%
SECOND	51.3%	49.5%	49.1%	46.1%	46.7%
UNCLASSIFIED	6.3%	7.6%	7.6%	10.3%	7.2%
	100.0%	100.0%	100.0%	100.0%	100.0%

DELUXE = means 5 star hotel  
FIRST = means 4 or 3 star hotel  
SECOND = means 2 or 1 star hotel

SOURCE: EGYPTIAN TOURIST AUTHORITY



TABLE (4.12)  
HOTEL OCCUPANCY RATES  
GROUPED BY REGION & CATEGORY

	CAIRO			ALEX			LUXOR			ASWAN			OTHER			MEAN		
	1987	1988	1989	1987	1988	1989	1987	1988	1989	1987	1988	1989	1987	1988	1989	1987	1988	1989
5 STAR	76.0	75.2	76.5	56.0	55.5	63.0	58.0	75.5	71.9	63.0	75.5	66.0	---	---	---	73.0	74.0	74.5
4 STAR	57.0	65.0	67.8	52.0	48.7	49.8	72.0	66.0	64.4	50.0	69.7	66.4	55.0	58.6	59.7	60.0	63.7	64.2
3 STAR	---	57.0	52.4	44.0	41.5	35.5	62.6	56.9	70.5	70.5	53.2	62.8	38.0	39.5	54.6	52.0	53.2	50.2
MEAN	73.0	71.6	72.3	52.0	49.5	50.6	69.0	70.5	67.9	62.0	70.0	65.7	49.0	43.0	57.0	68.5	69.0	68.8

SOURCE: EGYPTIAN TOURIST AUTHORITY

TABLE (4.13)

## EXPECTED SUPPLY OF HOTELS

## ACCOMMODATION CAPACITY IN 1990

ITEMS	UNITS	ROOMS	BEDS
HOTELS	403	37961	74207
TOURIST VILLAGES	37	5239	10801
FLOATING HOTELS	208	11099	21985
	-----	-----	-----
	648	54299	106993

ACCOMMODATION UNDER CONSTRUCTION  
PLAN (1992-1998)

ITEMS	UNITS	ROOMS	BEDS
HOTELS	88	9549	19175
TOURIST VILLAGES	62	3649	7434
FLOATING HOTELS	54	12224	24621
	-----	-----	-----
	204	25422	51230

## EXPECTED INCREASE IN ACCOMODATION FOR EACH ITEM :

HOTELS	43.1%	37.6%	37.4%
TOURIST VILLAGES	30.4%	14.4%	14.5%
FLOATING HOTELS	26.5%	48.1%	48.1%

SOURCE: MINISTRY OF TOURISM



Table (4.14)  
OPERATING STATEMENTS  
RATIO TO TOTAL REVENUES

REGIONS	AFRICA	EUROPE	U.K. HOTELS	CAIRO HOTELS
AVERAGE ANNUAL OCCUPANCY	64.0%	65.6%	65.0%	71.0%
AVERAGE ROOM RATE	\$52.84	\$80.23	\$79.42	\$63.47
	%	%	%	%
DEPARTMENTAL REVENUES:				
ROOMS	49.1	48.8	46.0	51.0
FOOD	28.7	30.1	31.1	28.0
BEVERAGE	11.3	13.2	14.0	8.0
OTHER FOOD & BEVERAGE	1.5	1.6	1.3	1.0
TELEPHONE	5.8	2.6	2.0	0.0
M.O.D.	1.7	2.1	3.3	8.0
RENTALS & OTHERS	1.9	1.6	2.3	4.0
TOTAL	100.0	100.0	100.0	100.0
DEPARTMENTAL EXPENSES:				
ROOMS	7.5	13.9	11.4	5.0
FOOD & BEVERAGE	30.7	33.2	32.5	22.6
TELEPHONE	4.8	1.5	1.3	0.0
M.O.D.	1.0	1.3	2.2	5.4
TOTAL	44.0	49.9	47.4	33.0
DEPARTMENTAL PROFITS:				
ROOMS	41.6	34.9	34.6	46.0
FOOD & BEVERAGE	10.8	11.7	13.9	14.4
TELEPHONE	1.0	1.1	0.7	0.0
M.O.D.	0.7	0.8	1.1	2.6
RENTALS & OTHER INCOME	1.9	1.6	2.3	4.0
TOTAL	56.0	50.1	52.6	67.0
UNDISTRIBUTED OPERATING EXP				
ADMINISTRATIVE & GENERAL	10.3	10.5	9.2	7.0
MARKETING	2.4	3.2	3.2	2.0
ENERGY COSTS	5.7	3.4	3.3	4.0
P.O.M.E.C	6.6	3.5	3.0	3.0
TOTAL UNDISTRIBUTED EXP	25.0	20.6	18.7	16.0
G.O.P.	31.0	29.5	33.9	51.0

SOURCE: 'WORLDWIDE HOTEL INDUSTRY 1991' BY HORWATH INTERNATIONAL.

SOURCE: CAIRO HOTEL ASSOCIATION 1990.

TABLE (6.1)  
CAIRO MARRIOTT  
FIXED ASSETS  
JUNE 1990

FIGURES '000 L.E.	COST	ACCUMULATED DEPREC	NET VALUE
LAND	701	0	701
BUILDING	86446	12536	73910
MACHINES	4723	1506	3217
CARS	140	140	0
HOTEL SUPPLIES	2954	2065	889
FURNITURE	11906	4761	7145
OTHER	0	0	0
	106870	21008	85862

CAIRO MARRIOTT FIXED CHARGES AS ALLOCATED IN EGOH ACCOUNTS

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
DEPRECIATION	5869000	6135000	4126000	2887000	2982000	4043000
REAL ESTATE TAXES	1092000	569000	492000	492000	492000	563000
INSURANCE	0	0	0	0	0	0
RENT	0	0	0	52000	0	0
INTEREST CHARGES	N.A.	5171000	230000	224000	436000	0

CAIRO MARRIOTT OCCUPANCY AND AVERAGE ROOM RATES

	1986	1987	1988	1989	1990
OCCUPANCY RATE	N.A.	N.A.	72.0%	72.7%	69.0%
AVERAGE ROOM RATE L.E.	N.A.	N.A.	146	171	189



TABLE (6.2)  
INCOME STATEMENT  
CAIRO MARRIOTT HOTEL

	1986	1987	1988	1989	1990
<hr/>					
REVENUES:					
ROOM	23010982	34955900	43932362	50669449	54285272
FOOD & BEVERAGE	15345269	21781831	26470174	32574262	33093480
CASINO	12895568	19362830	24440159	23582575	22365336
TELEPHONE & TELEX	3553823	6720656	6741563	7724768	8353867
LAUNDRY	866086	1070292	1080482	1050555	1115557
SPORTS CENTER	249036	287472	364227	388686	411041
GARAGE	88391	102612	217873	300283	348312
RENTALS & OTHER INC	4210117	5773998	5698125	7522961	7775599
<hr/>					
TOTAL REVENUES	60219272	90055591	108944965	123813539	127748464
COSTS:					
ROOMS	2133665	2683478	3212879	3984120	5063394
FOOD & BEVERAGE	9526058	12648877	15650474	18472540	18758984
CASINO	7396729	10709839	14105442	13696519	13228604
TELEPHONE & TELEX	2678145	3953477	3733437	4226346	4530120
LAUNDRY	194454	237530	259865	294577	254385
SPORTS CENTER	70396	96301	92662	104433	109831
GARAGE	34487	36419	40208	47336	50226
<hr/>					
TOTAL COSTS	22033934	30365921	37094967	40825871	41995544
GENERAL & ADM EXP	2232173	3750476	2970186	3387523	3845070
MARKETING	1792003	2532612	2400339	3046926	3000279
INSURANCE	278886	301115	462335	278820	310274
ENERGY COSTS	2529352	3799998	4180134	4643918	4962510
PROPERTY MAINTENANCE	1892948	2827710	3802716	5011548	5269156
OTHER PROVISIONS	109195	0	1137	488703	581229
AMORT OF PREOPEN EXP	718900	718900	718900	0	0
<hr/>					
TOTAL OVERHEAD	9553457	13930811	14535747	16857438	17968518
G.O.P.	28631881	45758859	57314251	66130230	67784402
MANAGEMENT FEES	6810000	11024000	13549000	15187000	15288000
OWNER'S SHARE	21821881	34734859	43765251	50943230	52496402

TABLE (6.3)  
INCOME STATEMENT  
CAIRO MARRIOTT HOTEL

PERCENTAGE CHANGE	1987	1988	1989	1990	OVERALL % CHANGE 1986-90
ROOM REVENUE	51.9%	25.7%	15.3%	7.1%	135.9%
F&B REVENUE	41.9%	21.5%	23.1%	1.6%	115.7%
CASINO REVENUE	50.2%	26.2%	-3.5%	-5.2%	73.4%
TEL & TLX REVENUE	89.1%	0.3%	14.6%	8.1%	135.1%
LAUNDRY REVENUE	23.6%	1.0%	-2.8%	6.2%	28.8%
SPORTS REVENUE	15.4%	26.7%	6.7%	5.8%	65.1%
GARAGE REVENUE	16.1%	112.3%	37.8%	16.0%	294.1%
RENTAL REVENUE	37.1%	-1.3%	32.0%	3.4%	84.7%
ROOMS COST	25.8%	19.7%	24.0%	27.1%	137.3%
F&B COST	32.8%	23.7%	18.0%	1.6%	96.9%
CASINO COST	44.8%	31.7%	-2.9%	-3.4%	78.8%
TEL & TLX COST	47.6%	-5.6%	13.2%	7.2%	69.2%
LAUNDRY COST	22.2%	9.4%	13.4%	-13.6%	30.8%
SPORTS COST	36.8%	-3.8%	12.7%	5.2%	56.0%
GARAGE COST	5.6%	10.4%	17.7%	6.1%	45.6%
GEN & ADM EXP	68.0%	-20.8%	14.1%	13.5%	72.3%
MKTG EXP	41.3%	-5.2%	26.9%	-1.5%	67.4%
INSURANCE COST	8.0%	53.5%	-39.7%	11.3%	11.3%
ENERGY COSTS	50.2%	10.0%	11.1%	6.9%	96.2%
P.O.M.E.C.	49.4%	34.5%	31.8%	5.1%	178.4%
OTHER PROVISIONS	-100.0%	E	42881.8%	18.9%	432.3%
AMORT PREOPEN EXP	0.0%	0.0%	-100.0%	E	-100.0%
G.O.P	59.8%	25.3%	15.4%	2.5%	136.7%

E = Infinity

TABLE (6.4)  
FINANCIAL ANALYSIS  
CAIRO MARRIOTT HOTEL

RATIOS AS % OF REV	1986	1987	1988	1989	1990
ROOM REV/TOTAL REV	38.2%	38.8%	40.3%	40.9%	42.5%
F&B REV/TOTAL REV	25.5%	24.2%	24.3%	26.3%	25.9%
CASINO REV/TOTAL REV	21.4%	21.5%	22.4%	19.0%	17.5%
TEL&TLX REV/TOT REV	5.9%	7.5%	6.2%	6.2%	6.5%
LAUNDRY REV/TOT REV	1.4%	1.2%	1.0%	0.8%	0.9%
SPORTS REV/TOT REV	0.4%	0.3%	0.3%	0.3%	0.3%
GARAGE REV/TOT REV	0.1%	0.1%	0.2%	0.2%	0.3%
RENTAL REV/TOT REV	7.0%	6.4%	5.2%	6.1%	6.1%
	100.0%	100.0%	100.0%	100.0%	100.0%
ROOMS COST/TOT REV	3.5%	3.0%	2.9%	3.2%	4.0%
F&B COST/TOT REV	15.8%	14.0%	14.4%	14.9%	14.7%
CASINO COST/TOT REV	12.3%	11.9%	12.9%	11.1%	10.4%
TEL&TLX COST/TOT REV	4.4%	4.4%	3.4%	3.4%	3.5%
LAUNDRY COST/TOT REV	0.3%	0.3%	0.2%	0.2%	0.2%
SPORTS COST/TOT REV	0.1%	0.1%	0.1%	0.1%	0.1%
GARAGE COST/TOT REV	0.1%	0.0%	0.0%	0.0%	0.0%
	36.6%	33.7%	34.0%	33.0%	32.9%
GEN & ADM EXP/TOT RE	3.7%	4.2%	2.7%	2.7%	3.0%
MRKETING EXP/TOT REV	3.0%	2.8%	2.2%	2.5%	2.3%
INSUR COST/TOT REV	0.5%	0.3%	0.4%	0.2%	0.2%
ENERGY COST/TOT REV	4.2%	4.2%	3.8%	3.8%	3.9%
P.O.M.E.C./TOT REV	3.1%	3.1%	3.5%	4.0%	4.1%
OTHER PROV/TOT REV	0.2%	0.0%	0.0%	0.4%	0.5%
AMORT PREOPE/TOT REV	1.2%	0.8%	0.7%	0.0%	0.0%
	15.9%	15.5%	13.3%	13.6%	14.1%
G.O.P	47.5%	50.8%	52.6%	53.4%	53.1%



TABLE (6.5)  
CAIRO MARRIOTT HOTEL  
% BREAKDOWN OF REVENUES & COSTS  
1989  
ROOMS DEPARTMENT

	1989	%
GROSS ROOMS REVENUE	50220895	99.1%
- DISCOUNTS & ALLOWANCES	-743403	-1.5%
	-----	-----
	49477492	97.6%
+ SHARE IN SERVICE CHARGE	1186224	2.3%
OTHER REVENUE	5733	0.0%
	-----	-----
NET ROOMS REVENUES	50669449	100.0%
LESS SALARIES		
SALARIES MANAGEMENT	219539	0.4%
SALARIES EMPLOYEES	461124	0.9%
EXTRA SALARIES	1769	0.0%
HIRED LABOR	3599	0.0%
HOLIDAYS	71247	0.1%
EMPLOYEES MEALS	252296	0.5%
OTHER INCENTIVES	371247	0.7%
	-----	-----
	1380821	2.7%
LESS OTHER EXPENSES		
PUBLIC RELATIONS	179971	0.4%
GLASSWEAR	15036	0.0%
LINENWEAR	466370	0.9%
CLEANING SUPPLIES	145102	0.3%
CLIENT SUPPLIES	545481	1.1%
STATIONARY	94076	0.2%
PHOTOCOPYING EXPENSES	16653	0.0%
HOSPITALITY	3681	0.0%
CLEANING CONTRACTS	4216	0.0%
DECORATIONS	66208	0.1%
TELEPHONE & FAX	46680	0.1%
LAUNDRY & DRY CLEANING	126516	0.2%
SURPLUS (DEFICIT) IN CASH	-553	0.0%
TRAVEL AGENTS COMMISSIONS	461020	0.9%
SUNDRY EXPENSES	15898	0.0%
EMPLOYEES CLOTHING	72807	0.1%
TRANSPORT	1950	0.0%
RESERVATION	0	0.0%
TRAVEL	0	0.0%
INTERNAL TRANSPORT	10108	0.0%
VIDEO	48298	0.1%
CENTRAL RESERVATION	0	0.0%
MEETING ROOM EXPENSES	245482	0.5%
MISCELLENIOUS EXPENSES	7206	0.0%
RECRUITMENT	30635	0.1%
OTHER EXPENSES	458	0.0%
	-----	-----
TOTAL OTHER EXPENSES	2603299	5.1%
TOTAL COSTS	3984120	7.9%
ROOMS DEPARTMENT PROFIT	46685329	92.1%

TABLE (6.6)  
CAIRO MARRIOTT HOTEL  
F&B DEPARTMENT

	1989	%
FOOD REVENUE	22764275	69.9%
BEVERAGE REVENUE	7346510	22.6%
OTHER F&B REVENUE	1116655	3.4%
BANQUET ROOMS REVENUE	656467	2.0%
SHARE IN SERVICE CHARGE	690355	2.1%
	-----	-----
GROSS F&B REVENUE	32574262	100.0%
FOOD COST	7814762	24.0%
BEVERAGE COST	2347758	7.2%
ROOMS RENTAL	0	0.0%
	-----	-----
TOTAL COST OF SALES	10162520	31.2%
SALARIES MANAGEMENT	822398	2.5%
SALARIES EMPLOYEES	1204365	3.7%
OVERTIME	23734	0.1%
HIRED LABOR	79191	0.2%
HOLIDAYS	198659	0.6%
EMPLOYEE MEALS	473710	1.5%
SICK LEAVES	13470	0.0%
OTHER INCENTIVES	1210106	3.7%
	-----	-----
TOTAL SALARIES	4025633	12.4%
PUBLIC RELATIONS	37817	0.1%
CHINAWEAR	219544	0.7%
GLASSWEAR	141880	0.4%
SILVERWEAR	63436	0.2%
OTHER SUPPLIES	246418	0.8%
PAPER SUPPLIES	270381	0.8%
LINENWEAR	88904	0.3%
CLEANING SUPPLIES	89577	0.3%
WASHING MACHINE SUPPLIES	15373	0.0%
CLIENTS SUPPLIES	56442	0.2%
STATIONARY	169193	0.5%
MENUES	49140	0.2%
HOSPITALITY	52127	0.2%
PHOTOCOPYING	6046	0.0%
CLEANING CONTRACTS	26389	0.1%
DECORATIONS	181734	0.6%
TELEPHONE & TELEX	41458	0.1%
LAUNDRY & DRY CLEANING	70888	0.2%
TRAVEL	6856	0.0%
SURPLUS (DEFICIT) IN CASH	389	0.0%
EMPLOYMENT EXPENSES	14332	0.0%
MISCELLANEOUS EXPENSES	74964	0.2%
EMPLOYEE CLOTHING	185735	0.6%
FREE MEALS CLIENTS	96233	0.3%
MUSIC & DISCO	1861294	5.7%
BREAKAGE EXPENSES	183946	0.6%
MEETING EXPENSES	11322	0.0%
SUNDRY EXPENSES	22569	0.1%
	-----	-----
TOTAL OTHER EXPENSES	4284387	13.2%
TOTAL COSTS	18472540	56.7%
F&B DEPARMENT PROFIT	14101722	43.3%

TABLE (6.7)  
CAIRO MARRIOTT HOTEL  
% BREAKDOWN OF REVENUES & COSTS  
1989

CASINO DEPARTMENT		
	1989	%
NET REVENUES	23582575	100.0%
	-----	-----
COST OF SALES	12705	0.1%
LESS SALARIES		
SALARIES MANAGEMENT	267059	1.1%
SALARIES EMPLOYEES	241661	1.0%
OVERTIME	11204	0.0%
- SHARE IN SERVICE CHARGE	-482271	-2.0%
HOLIDAYS	58241	0.2%
EMPLOYEE MEALS	111306	0.5%
SICK LEAVES	1271	0.0%
OTHER INCENTIVES	297594	1.3%
	-----	-----
	506065	2.1%
LESS OTHER EXPENSES		
TAXES	11546115	49.0%
PUBLIC RELATIONS	177600	0.8%
CLEANING SUPPLIES	3771	0.0%
STATIONARY	14269	0.1%
PHOTOCOPYING	3650	0.0%
MAINTENANCE	3861	0.0%
DECORATIONS	16205	0.1%
TELEPHONE & TELEX	7153	0.0%
CASINO SUPPLIES	77533	0.3%
CURRENCY SWAPS	17376	0.1%
SURPLUS (DEFICIT) IN CASH	279	0.0%
EMPLOYEES CLOTHING	55852	0.2%
SECURITY	14590	0.1%
MISCELLANEOUS EXPENSES	9535	0.0%
LAUNDRY & DRY CLEANING	3938	0.0%
CLEANING CONTRACTS	2984	0.0%
AUDITING EXPENSES	14000	0.1%
CLIENT SUPPLIES	716	0.0%
BANKING EXPENSES	47	0.0%
HOSPITALITY	6164	0.0%
PROFESSIONAL EXPENSES	0	0.0%
CREDIT CARD COMMISSION	0	0.0%
GLASSES	0	0.0%
BREAKAGE	1197411	5.1%
REPAIR CONTRACTS	0	0.0%
OTHER EXPENSES	4700	0.0%
	-----	-----
	13177749	55.9%
TOTAL COSTS	13696519	58.1%
CASINO DEPARTMENT PROFIT	9886056	41.9%



TABLE (6.8)  
CAIRO MARRIOTT HOTEL  
% BREAKDOWN OF REVENUES & COSTS  
1989

TEL & TLX DEPARTMENT

	1989	%
REVENUES:		
LOCAL CALLS	335862	4.3%
INTERNATIONAL CALLS	7125079	92.2%
TELEX	51965	0.7%
FAX	361277	4.7%
OTHERS	34869	0.5%
LESS DISCOUNTS & ALLOWANCES	-184284	-2.4%
	-----	-----
NET REVENUE	7724768	100.0%
LESS COSTS		
LOCAL	87923	1.1%
INTERNATIONAL	3659094	47.4%
TELEX	27961	0.4%
FAX	179189	2.3%
	-----	-----
	3954167	51.2%
LESS SALARIES		
EMPLOYEES SALARIES	59286	0.8%
HIRED LABOR	72	0.0%
HOLIDAYS	5056	0.1%
EMPLOYEES MEALS	21465	0.3%
MEDICAL CARE	430	0.0%
OTHERS	21815	0.3%
	-----	-----
	108124	1.4%
LESS OTHER EXPENSES		
STATIONARY	23472	0.3%
SUNDRY EXPENSES	959	0.0%
MAINTENANCE	133835	1.7%
POSTAGE	313	0.0%
EMPLOYEE CLOTHING	439	0.0%
OTHERS	5037	0.1%
	-----	-----
	164055	2.1%
TOTAL COSTS	4226346	54.7%
TEL & TLX DEPT PROFIT	3498422	45.3%

TABLE (6.9)  
CAIRO MARRIOTT HOTEL  
% BREAKDOWN OF REVENUES & COSTS -  
1989

LAUNDRY & DRY CLEANING DEPARTMENT

	1989	%
REVENUES		
LAUNDRY	659680	62.8%
DRY CLEANING CLIENTS	330448	31.5%
DRY CLEANING OUTSIDERS	95981	9.1%
LESS ALLOWANCES & DISCOUNTS	-35554	-3.4%
	-----	-----
NET REVENUES	1050555	100.0%
	-----	-----
LESS COST OF SALES	271739	25.9%
LESS SALARIES		
EMPLOYEES	5673	0.5%
OVERTIME	339	0.0%
HOLIDAYS	466	0.0%
EMPLOYEE MEALS	2146	0.2%
MEDICAL CARE	129	0.0%
OTHERS	1925	0.2%
	-----	-----
	10678	1.0%
LESS OTHER EXPENSES		
STATIONARY	8760	0.8%
PHOTOCOPYING	132	0.0%
WASHING SUPPLIES	2008	0.2%
DRYING SUPPLIES	1260	0.1%
EMPLOYEES CLOTHING	0	0.0%
	-----	-----
	12160	1.2%
TOTAL COSTS	294577	28.0%
LAUNDRY DEPT PROFIT	755978	72.0%

TABLE (6.10)  
CAIRO MARRIOTT HOTEL  
% BREAKDOWN OF REVENUES & COSTS  
1989

HEALTH CENTER		
	1989	%
REVENUES		
MEMBERSHIP	116427	30.0%
TENNIS COURTS	15521	4.0%
OTHER REVENUES	5717	1.5%
LESS DISCOUNTS & ALLOWANCES	-1135	-0.3%
TEMPORARY MEMBERSHIP	100913	26.0%
DAILY REVENUE	151243	38.9%
	-----	-----
	388686	100.0%
	-----	-----
LESS SALARIES		
EMPLOYEES	21387	5.5%
HIRED LABOR	1996	0.5%
OVERTIME	69	0.0%
HOLIDAYS	1717	0.4%
EMPLOYEE MEALS	10732	2.8%
MEDICAL CARE	193	0.0%
OTHER INCENTIVES	7614	2.0%
	-----	-----
	43708	11.2%
LESS OTHER EXPENSES		
LINENWEAR	16271	4.2%
CLEANING SUPPLIES	1073	0.3%
GUEST SUPPLIES	10436	2.7%
STATIONARY	2158	0.6%
SWIMMING SUPPLIES	12943	3.3%
DECORATIONS	425	0.1%
LAUNDRY & DRY CLEANING	5907	1.5%
GENERAL EXPENSES	7128	1.8%
EMPLOYEE EXPENSES	4384	1.1%
	-----	-----
	60725	15.6%
TOTAL COSTS		
	104433	26.9%
HEALTH CENTER PROFIT		
	284253	73.1%



TABLE (6.11)  
CAIRO MARRIOTT HOTEL  
% BREAKDOWN OF REVENUES & COSTS  
1989

GARAGE		
	1989	%
REVENUES		
MEMBERSHIP	43015	14.3%
DAILY REVENUE	257412	85.7%
LESS ALLOWANCES & DISCOUNTS	-144	0.0%
	-----	-----
	300283	100.0%
LESS SALARIES		
EMPLOYEES	18698	6.2%
OVERTIME	1084	0.4%
HOLIDAYS	1347	0.4%
EMPLOYEE MEALS	8586	2.9%
MEDICAL CARE	273	0.1%
OTHER INCENTIVES	7063	2.4%
	-----	-----
	37051	12.3%
LESS OTHER EXPENSES		
STATIONARY	4427	1.5%
EMPLOYEE CLOTHING	5453	1.8%
OTHERS	405	0.1%
	-----	-----
	10285	3.4%
TOTAL COSTS	47336	15.8%
GARAGE PROFIT	252947	84.2%

TABLE (6.12)  
CAIRO MARRIOTT HOTEL  
% BREAKDOWN OF REVENUES & COSTS  
1989

RENTALS & OTHER INCOME		
	1989	%
REVENUES:		
SHOP RENTALS	1725791	22.9%
CURRENCY CHANGES	340165	4.5%
EXTRA ON SALES	491750	6.5%
SERVICE REVENUE	3911281	52.0%
INTEREST ON DEPOSITS	986359	13.1%
OTHER REVENUES	33365	0.4%
CANCELLED CHECKS	34250	0.5%
	-----	-----
	7522961	100.0%

TABLE (6.13)  
BASIC ASSUMPTIONS

NO. OF DAYS	365	365	365	365	365
NO. OF ROOMS	1147	1147	1147	1147	1147
AVERAGE ROOM RATE	375.00	450.00	540.00	648.00	777.60
OCCUPANCY RATE	0.75	0.75	0.75	0.85	0.85
AVAILABLE ROOMS	418655	418655	418655	418655	418655
OCCUPIED ROOMS	313991	313991	313991	355857	355857

CASH FLOW PROJECTION  
CAIRO MARRIOTT HOTEL

	1993	1994	1995	1996	1997
REVENUES:	283727033	340472440	408566928	555651022	666781226
ROOM	117746719	141296063	169555275	230595174	276714209
FOOD & BEVERAGE	73769029	88522834	106227401	144469266	173363119
CASINO	53908136	64689764	77627716	105573694	126688433
TELEPHONE & TELEX	17023622	20428346	24514016	33339061	40006874
LAUNDRY	2837270	3404724	4085669	5556510	6667812
SPORTS CENTER	851181	1021417	1225701	1666953	2000344
GARAGE	567454	680945	817134	1111302	1333562
RENTALS	17023622	20428346	24514016	33339061	40006874
TOTAL REVENUES	283727033	340472440	408566928	555651022	666781226
COSTS:					
ROOMS	9930446	11916535	14299842	19447786	23337343
FOOD & BEVERAGE	38303149	45963779	55156535	75012888	90015466
CASINO	29791338	35749606	42899527	58343357	70012029
TELEPHONE & TELEX	8511811	10214173	12257008	16669531	20003437
LAUNDRY	567454	680945	817134	1111302	1333562
SPORTS CENTER	283727	340472	408567	555651	666781
GARAGE	141864	170236	204283	277826	333391
	87529790	105035748	126042897	171418340	205702008
GEN & ADM EXP	8511811	10214173	12257008	16669531	20003437
MKTG EXP	5674541	6809449	8171339	11113020	13335625
INSURANCE EXP	567454	680945	817134	1111302	1333562
ENERGY COST	11349081	13618898	16342677	22226041	26671249
P.O.M.E.C.	11349081	13618898	16342677	22226041	26671249
OTHER PROVISIONS	141864	170236	204283	277826	333391
	37593832	45112598	54135118	73623760	88348512
G.O.P.	158603412	190324094	228388913	310608921	372730705
G.O.P./REVENUES	55.9%	55.9%	55.9%	55.9%	55.9%
MANAGEMENT FEES	26962580	32355096	38826115	52803517	63364220
NET OWNER'S PROFIT	131640832	157968998	189562797	257805405	309366485
NPV	1646024391	L.E.		\$ 491350564	



TABLE (6.14)  
CAIRO SHERATON  
FIXED ASSETS  
ON 30/6/1990

AMOUNTS IN '000 L.E.

ITEMS	COST	ACCUMULATED DEPRECIATION	NET VALUE
LAND	290	0	290
BUILDING	75251	2880	72371
MACHINES	7230	1564	5666
CARS	33	12	21
HOTEL SUPPLIES	1558	580	978
FURNITURE	12637	1490	11147
OTHER	797	159	638
	97796	6685	91111

\* Management purchased L.E. 5 million for fixture for the new tower  
at the Cairo Sheraton

SHERATON FIXED CHARGES AS ALLOCATED IN EGOTH ACCOUNTS

	85/86	86/87	87/88	88/89	89/90	90/91
DEPRECIATION	447000	456000	454000	486000	2799000	3158000
REAL ESTATE TAX	19000	39000	33000	33000	33000	39000
INSURANCE	0	0	0	0	0	0
RENT	0	0	0	0	0	0
INTEREST CHARGES	N.A.	0	0	8477000	13021000	N.A.
TOTAL CHARGES	466000	495000	487000	8996000	15853000	3197000

SHERATON OCCUPANCY AND AVERAGE ROOM RATES

	1986	1987	1988	1989	1990
OCCUPANCY RATE	70.6%	82.2%	85.7%	83.8%	73.1%
AVERAGE ROOM RATE L.E.	48.0	78.0	101.0	119.0	171.0

TABLE (6.15)  
INCOME STATEMENT  
CAIRO SHERATON HOTEL

	1986	1987	1988	1989	1990
<hr/>					
REVENUES:					
ROOM	4607847	7953844	9277517	15800215	26416051
FOOD & BEVERAGE	7383051	8231252	9379147	12797323	16563770
CASINO	6803587	8625415	8890083	7420427	8712821
TELEPHONE & TELEX	0	0	0	1689344	3206788
OTHER INCOME	1182655	1399627	1509934	335686	543563
RENTALS	281218	468541	375286	480477	2731114
<hr/>					
TOTAL REVENUES	20258358	26678679	29431967	38523472	58174107
 COSTS:					
ROOMS	1100353	1266298	1413314	2058227	3050959
FOOD & BEVERAGE	5004541	6992253	7933072	10058721	12005715
CASINO	5639193	5259155	5464008	4754091	5615073
TELEPHONE & TELEX	0	0	0	1489431	2422835
OTHER EXPENSES	984362	1165083	1110989	191336	198060
<hr/>					
TOTAL COSTS	12728449	14682789	15921383	18551806	23292642
GENERAL & ADM EXP	1369604	1351245	1538299	2010636	2617581
MKTG & ADV	135786	133599	148794	1142710	1675123
INTERNATIONAL MKTG	134797	180945	205419	0	0
PUBLIC RELATIONS	44809	33622	16270	0	0
SALES DEPT	360402	216565	362552	0	0
ENERGY COSTS	339457	510921	745495	1104345	1489505
PROPERTY MAINTENANCE	906220	1139725	1311788	1516158	1853077
OTHER PROVISIONS	-31095	226437	0	77954	-1056068
PROFITS CUR VALUAT.	-340	-324692	-100221	0	0
INSURANCE	236855	246986	157769	0	0
AMORT. PREOPEN EXP	87686	0	0	0	0
REPLACEMENT PROVIS.	811331	1068797	0	1540863	2326964
OWNER/MANAGER EXP	419081	0	1177279	0	0
<hr/>					
TOTAL EXPENSES	4814593	4784150	5563444	7392666	8906182
G.O.P.	2715316	7211740	7947140	12579000	25975283
MANAGEMENT FEES	N.A.	N.A.	N.A.	N.A.	4494000
OWNER'S SHARE	N.A.	N.A.	N.A.	N.A.	21481283

TABLE (6.16)  
INCOME STATEMENT  
CAIRO SHERATON HOTEL

PERCENTAGE CHANGE	1987	1988	1989	1990	OVERALL % CHANGE 1986-90
ROOM REVENUE	72.6%	16.6%	70.3%	67.2%	473.3%
F&B REVENUE	11.5%	13.9%	36.4%	29.4%	124.3%
CASINO REVENUE	26.8%	3.1%	-16.5%	17.4%	28.1%
TEL & TLX REVENUE	N.E.	N.E.	N.E.	89.8%	E
OTHER INCOME REVENUE	18.3%	7.9%	-77.8%	61.9%	-54.0%
RENTAL REVENUE	66.6%	-19.9%	28.0%	468.4%	871.2%
ROOMS COST	15.1%	11.6%	45.6%	48.2%	177.3%
F&B COST	39.7%	13.5%	26.8%	19.4%	139.9%
CASINO COST	-6.7%	3.9%	-13.0%	18.1%	-0.4%
TEL & TLX COST	N.E.	N.E.	N.E.	62.7%	E
OTHER EXPENSES	18.4%	-4.6%	-82.8%	3.5%	-79.9%
GEN & ADM EXP	-1.3%	13.8%	30.7%	30.2%	91.1%
MKTG EXP	-1.6%	11.4%	668.0%	46.6%	1133.6%
INT MKTG	34.2%	13.5%	-100.0%	N.E.	-100.0%
PUB REL EXP	-25.0%	-51.6%	-100.0%	N.E.	-100.0%
SALES DEPT EXP	-39.9%	67.4%	-100.0%	N.E.	-100.0%
ENERGY COSTS	50.5%	45.9%	48.1%	34.9%	338.8%
P.O.M.E.C.	25.8%	15.1%	15.6%	22.2%	104.5%
OTHER PROVISIONS	-828.2%	-100.0%	N.E.	-1454.7%	3296.3%
PROFIT CUR VAL	95397.6%	-69.1%	-100.0%	N.E.	-100.0%
INSURANCE EXP	4.3%	-36.1%	-100.0%	N.E.	-100.0%
AMOR PREOPEN EXP	-100.0%	N.E.	N.E.	N.E.	-100.0%
REPLACEMENT PROV	31.7%	-100.0%	N.E.	51.0%	186.8%
OWNER/MANAGER EXP	-100.0%	N.E.	-100.0%	N.E.	-100.0%
G.O.P	165.6%	10.2%	58.3%	106.5%	856.6%

N.E. = Not existing

E = Infinity



TABLE (6.17)  
FINANCIAL ANALYSIS  
CAIRO SHERATON HOTEL

RATIOS AS % OF REV	1986	1987	1988	1989	1990
ROOM REV/TOTAL REV	22.7%	29.8%	31.5%	41.0%	45.4%
F&B REV/TOTAL REV	36.4%	30.9%	31.9%	33.2%	28.5%
CASINO REV/TOT REV	33.6%	32.3%	30.2%	19.3%	15.0%
TELEP & TLX/TOT REV	0.0%	0.0%	0.0%	4.4%	5.5%
OTHER INCOME/TOT REV	5.8%	5.2%	5.1%	0.9%	0.9%
RENTAL REV/TOT REV	1.4%	1.8%	1.3%	1.2%	4.7%
	100.0%	100.0%	100.0%	100.0%	100.0%
ROOMS COST/TOT REV	5.4%	4.7%	4.8%	5.3%	5.2%
F&B COST/TOT REV	24.7%	26.2%	27.0%	26.1%	20.6%
CASINO COST/TOT REV	27.8%	19.7%	18.6%	12.3%	9.7%
TELEP & TLX/TOT REV	0.0%	0.0%	0.0%	3.9%	4.2%
OTHER EXP/TOT REV	4.9%	4.4%	3.8%	0.5%	0.3%
	62.8%	55.0%	54.1%	48.2%	40.0%
GEN & ADM EXP/TOT RE	6.8%	5.1%	5.2%	5.2%	4.5%
MKTG EXP/TOT REV	0.7%	0.5%	0.5%	3.0%	2.9%
INT MKTG/TOT REV	0.7%	0.7%	0.7%	0.0%	0.0%
PUB REL EXP/TOT REV	0.2%	0.1%	0.1%	0.0%	0.0%
SALES DEPT/TOT REV	1.8%	0.8%	1.2%	0.0%	0.0%
ENERGY COST/TOT REV	1.7%	1.9%	2.5%	2.9%	2.6%
P.O.M.E.C./TOT REV	4.5%	4.3%	4.5%	3.9%	3.2%
OTHER PROV/TOT REV	-0.2%	0.8%	0.0%	0.2%	-1.8%
PROF CUR VAL/TOT REV	0.0%	-1.2%	-0.3%	0.0%	0.0%
INSURANCE/TOT REV	1.2%	0.9%	0.5%	0.0%	0.0%
AMOR PREOPEN/TOT REV	0.4%	0.0%	0.0%	0.0%	0.0%
REPLAC PROV/TOT REV	4.0%	4.0%	0.0%	4.0%	4.0%
OWN/MGR EXP/TOT REV	2.1%	0.0%	4.0%	0.0%	0.0%
	23.8%	17.9%	18.9%	19.2%	15.3%
G.O.P	13.4%	27.0%	27.0%	32.7%	44.7%

TABLE (6.18)  
CAIRO SHERATON HOTEL  
PERCENTAGE BREAKDOWN  
OF REVENUES & COSTS  
1989

ROOM DEPARTMENT		
L.E.	1989	%
NET ROOMS REVENUE	15800215	100.0%
	-----	-----
LESS COSTS		
SALARIES	983715	6.2%
EXTRA SALARIES	675422	4.3%
- SHARE IN SERVICE CHARGE	-891855	-5.6%
	-----	-----
	767282	4.9%
LESS OTHER EXPENSES		
CLEANING SUPPLIES	37396	0.2%
LAUNDRY	317990	2.0%
GUEST SUPPLIES	550992	3.5%
TRAVEL AGENCIES COMISSION	113989	0.7%
RESERVATION EXPENSES	4230	0.0%
VIDEO	42633	0.3%
DECORATIONS	65267	0.4%
TRAVEL	4770	0.0%
TELEPHONE	14173	0.1%
SUNDRY EXPENSES	139503	0.9%
	-----	-----
	1290943	8.2%
TOTAL COSTS	2058225	13.0%
ROOMS DEPARTMENT PROFIT	13741990	87.0%

TABLE (6.19)  
CAIRO SHERATON HOTEL  
PERCENTAGE BREAKDOWN  
OF REVENUES & COSTS  
1989

F&B DEPARTMENT

L.E.	1989	%
FOOD REVENUE	9975659	78.0%
BEVERAGE REVENUE	2642561	20.6%
OTHER FOOD INCOME	179103	1.4%
	-----	-----
NET F&B REVENUE	12797323	100.0%
	-----	-----
LESS DIRECT COSTS		
COST OF FOOD CONSUMED	4749688	37.1%
COST OF BEVERAGE CONSUMED	924497	7.2%
COST OF EMPLOYEES MEALS	-950786	-7.4%
	-----	-----
TOTAL DIRECT COSTS	4723399	36.9%
LESS INDIRECT COSTS		
SALARIES & WAGES	1876548	14.7%
EXTRA SALARIES	1336452	10.4%
- SHARE IN SERVICE CHARGE	-781907	-6.1%
	-----	-----
TOTAL INDIRECT COSTS	2431093	19.0%
LESS OTHER EXPENSES		
CLEANING SUPPLIES	35919	0.3%
LAUNDRY	77622	0.6%
ENTERTAINMENT EXPENSES	2122948	16.6%
GUEST SUPPLIES	324165	2.5%
F&B MENUES	10622	0.1%
DECORATIONS	55421	0.4%
TELEPHONE	4120	0.0%
TRANSPORT	34875	0.3%
SUNDRY EXPENSES	238537	1.9%
	-----	-----
	2904229	22.7%
TOTAL COSTS	10058721	78.6%
F&B DEPARTMENT PROFIT	2738602	21.4%



TABLE (6.20)  
CAIRO SHERATON HOTEL  
PERCENTAGE BREAKDOWN  
OF REVENUES & COSTS  
1989

CASINO		
L.E.	1989	%
CASINO GROSS REVENUE	27357222	
LESS PAID TO PLAYERS	19936795	
	-----	
	7420427	100.0%
	-----	-----
LESS INDIRECT COSTS		
SALARIES & WAGES	430107	5.8%
EXTRA SALARIES	331123	4.5%
- SHARE OF CASINO IN TIPS	0	0.0%
	-----	-----
	761230	10.3%
LESS OTHER EXPENSES		
CLEANING SUPPLIES	1541	0.0%
ENTERTAINMENT	15029	0.2%
SUPPLIES	30369	0.4%
TAXES	3710214	50.0%
FOOD & BEVERAGE	140918	1.9%
CIGARETTES	0	0.0%
SUNDRY EXPENSES	13519	0.2%
TRANSPORT	3584	0.0%
TELEPHONE	3624	0.0%
ARTISTS	74063	1.0%
	-----	-----
	3992861	53.8%
TOTAL COSTS	4754091	64.1%
CASINO PROFIT	2666336	35.9%

TABLE (6.21)  
CAIRO SHERATON HOTEL  
PERCENTAGE BREAKDOWN  
OF REVENUES & COSTS  
1989

TELEPHONE & TELEX DEPT

L.E.	1989	%
REVENUES		
INTERNATIONAL CALLS	1404116	83.1%
LOCAL CALLS	43683	2.6%
FAX	229255	13.6%
TELEX	12290	0.7%
	-----	-----
	1689344	100.0%
	-----	-----
LESS COST OF SALES		
TELEPHONE	1218718	72.1%
FAX	170624	10.1%
TELEX	10848	0.6%
	-----	-----
	1400190	82.9%
	-----	-----
LESS COSTS		
SALARIES & WAGES	90601	5.4%
EXTRA SALARIES	59682	3.5%
- SHARE IN SERVICE CHARGE	-88180	-5.2%
	-----	-----
	62103	3.7%
	-----	-----
LESS OTHER EXPENSES		
SUPPLIES	15295	0.9%
MAINTENANCE	150	0.0%
SUNDRY EXPENSES	11693	0.7%
	-----	-----
	27138	1.6%
	-----	-----
TOTAL COSTS	1489431	88.2%
TEL & TLX DEPT PROFIT	199913	11.8%

TABLE (6.22)  
CAIRO SHERATON HOTEL  
PERCENTAGE BREAKDOWN  
OF REVENUES & COSTS  
1989

MINOR OPERATED DEPARTMENTS  
M.O.D.

L.E.	1989	%
REVENUES		
LAUNDRY	182882	54.5%
DRY CLEANING	147764	44.0%
SUNDRY	5040	1.5%
	-----	-----
	335686	100.0%
	-----	-----
LESS COST OF SALES		
LAUNDRY	54865	16.3%
DRY CLEANING	44329	13.2%
SALARIES & WAGES	92142	27.4%
	-----	-----
	191336	57.0%
M.O.D. PROFIT	144350	43.0%



TABLE (6.23)  
CAIRO SHERATON HOTEL  
PERCENTAGE BREAKDOWN  
OF REVENUES & COSTS  
1989

RENTALS & OTHER INCOME

L.E.	1989	%
REVENUES		
RENTALS	442010	92.0%
OTHER INCOME	38467	8.0%
	-----	-----
	480477	100.0%
	-----	-----

TABLE (6.24)  
BASIC ASSUMPTIONS

NO. OF DAYS	365	365	365	365	365
NO. OF ROOMS	660	660	660	660	660
AVERAGE ROOM RATE	275.00	330.00	396.00	475.20	570.24
OCCUPANCY RATE	0.8	0.8	0.8	0.8	0.8
AVAILABLE ROOMS	240900	240900	240900	240900	240900
OCCUPIED ROOMS	192720	192720	192720	192720	192720

CASH FLOW FORECAST  
CAIRO SHERATON HOTEL

	1993	1994	1995	1996	1997
REVENUES:	120450000	144540000	173448000	208137600	249765120
ROOM	52998000	63597600	76317120	91580544	109896653
FOOD & BEVERAGE	33726000	40471200	48565440	58278528	69934234
CASINO	20476500	24571800	29486160	35383392	42460070
TELEPHONE & TELEX	6022500	7227000	8672400	10406880	12488256
OTHER INCOME	1204500	1445400	1734480	2081376	2497651
RENTALS	6022500	7227000	8672400	10406880	12488256
TOTAL REVENUES	120450000	144540000	173448000	208137600	249765120
COSTS:					
ROOMS	5420250	6504300	7805160	9366192	11239430
FOOD & BEVERAGE	18067500	21681000	26017200	31220640	37464768
CASINO	10840500	13008600	15610320	18732384	22478861
TELEPHONE & TELEX	3613500	4336200	5203440	6244128	7492954
OTHER EXPENSES	602250	722700	867240	1040688	1248826
TOTAL COSTS	38544000	46252800	55503360	66604032	79924838
GENERAL & ADM EXP	6022500	7227000	8672400	10406880	12488256
MKTG & ADV	2409000	2890800	3468960	4162752	4995302
INTERNATIONAL MKTG	0	0	0	0	0
PUBLIC RELATIONS	0	0	0	0	0
SALES DEPT	0	0	0	0	0
ENERGY COSTS	4818000	5781600	6937920	8325504	9990605
PROPERTY MAINTENANCE	3613500	4336200	5203440	6244128	7492954
OTHER PROVISIONS	0	0	0	0	0
PROFITS CUR VALUAT.	0	0	0	0	0
INSURANCE	0	0	0	0	0
AMORT. PREOPEN EXP	0	0	0	0	0
REPLACEMENT PROVIS.	4818000	5781600	6937920	8325504	9990605
OWNER/MANAGER EXP	0	0	0	0	0
TOTAL EXPENSES	21681000	26017200	31220640	37464768	44957722
G.O.P.	60225000	72270000	86724000	104068800	124882560
G.O.P./REVENUES	50.0%	50.0%	50.0%	50.0%	50.0%
MANAGEMENT FEES	9636000	11563200	13875840	16651008	19981210
NET OWNER'S PROFIT	50589000	60706800	72848160	87417792	104901350
NPV	548561984	L.E.		\$ 163749846	

TABLE (6.25)  
ASWAN OBEROI  
FIXED ASSETS  
JUNE 1990

FIGURES '000 L.E.	COST	DEPRECIATION	NET VALUE
LAND	66	0	66
BUILDING	9046	1068	7978
MACHINES	1549	746	803
CARS	102	101	1
HOTEL SUPPLIES	1029	983	46
FURNITURE	1387	434	953
OTHER	1	0	1
	13180	3332	9848

ASWAN OBEROI FIXED CHARGES AS ALLOCATED IN EGOH ACCOUNTS

	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
DEPRECIATION	261000	255000	307000	249000	460000	282000
REAL ESTATE TAXES	13000	6000	13000	41000	13000	16000
INSURANCE	0	13000	0	0	0	0
RENT	0	0	70000	52000	98000	100600
INTEREST CHARGES	N.A.	0	0	633000	972000	N.A.

ASWAN OBEROI OCCUPANCY AND AVERAGE ROOM RATES

	1986	1987	1988	1989	1990
OCCUPANCY	48.3%	82.3%	76.4%	78.9%	64.3%
AVERAGE ROOM RATE L.E.	48.7	65.1	106	150	164



TABLE (6.26)  
INCOME STATEMENT  
ASWAN OBEROI HOTEL

	1986	1987	1988	1989	1990
<hr/>					
REVENUES:					
ROOM	1333342	3085475	4749593	6857703	6299000
FOOD & BEVERAGE	1567476	3507606	4235864	5048169	4448000
TELEPHONE & TELEX	157307	287542	308207	317387	320000
OTHER OPERATING DEPT	53011	85960	114982	164918	92000
RENTALS & OTHER INC	40186	291836	69741	374745	627000
<hr/>					
TOTAL REVENUES	3151322	7258419	9478387	12762922	11786000
COSTS:					
TOTAL OPERATING COST	1721302	2630148	3465907	4016673	3817000
OTHER PROVISIONS	0	0	0	0	561000
GENERAL & ADM EXP	350484	406205	615189	610585	1116000
MARKETING	90266	112255	162204	283342	202000
ENERGY COSTS	99537	133725	186336	304146	395000
REPAIR & MAINTENANCE	219265	357638	646424	912437	598000
RENEWAL/REPLACEMENT	126053	290336	379136	854622	472000
<hr/>					
TOTAL OVERHEAD	885605	1300159	1989289	2965132	3344000
G.O.P.	544415	3328112	4023191	5781117	4625000
OWNER'S SHARE	462753	2828895	3419712	4913949	3931250
MANAGEMENT FEES	81662	499217	603479	867168	693750

TABLE (6.27)  
INCOME STATEMENT  
ASWAN OBEROI HOTEL

PERCENTAGE CHANGE	1987	1988	1989	1990 OVERALL % CHANGE 1896	
ROOM REVENUE	131.4%	53.9%	44.4%	-8.1%	372.4%
F&B REVENUE	123.8%	20.8%	19.2%	-11.9%	183.8%
TEL & TLX REVENUE	82.8%	7.2%	3.0%	0.8%	103.4%
M.O.D. REVENUE	62.2%	33.8%	43.4%	-44.2%	73.5%
RENTAL & OTHER REV	626.2%	-76.1%	437.3%	67.3%	1460.2%
COST OF SALES	52.8%	31.8%	15.9%	-5.0%	121.8%
OTHER PROVISIONS	0.00	0.00	0.00	E	E
GEN & ADM EXP	15.9%	51.4%	-0.7%	82.8%	218.4%
MKTG EXP	24.4%	44.5%	74.7%	-28.7%	123.8%
ENERGY COSTS	34.3%	39.3%	63.2%	29.9%	296.8%
P.O.M.E.C.	63.1%	80.7%	41.2%	-34.5%	172.7%
OTHER PROVISIONS	130.3%	30.6%	125.4%	-44.8%	274.4%
G.O.P	511.3%	20.9%	43.7%	-20.0%	749.5%

E = Infinity

TABLE (6.28)  
FINANCIAL ANALYSIS  
ASWAN OBEROI HOTEL

RATIOS AS % OF REV	1986	1987	1988	1989	1990
ROOM REV/TOTAL REV	42.3%	42.5%	50.1%	53.7%	53.4%
F&B REV/TOTAL REV	49.7%	48.3%	44.7%	39.6%	37.7%
TEL&TLX REV/TOT REV	5.0%	4.0%	3.3%	2.5%	2.7%
M.O.D. REV/TOT REV	1.7%	1.2%	1.2%	1.3%	0.8%
RENTAL REV/TOT REV	1.3%	4.0%	0.7%	2.9%	5.3%
	100.0%	100.0%	100.0%	100.0%	100.0%
COST OF SALES/T REV	54.6%	36.2%	36.6%	31.5%	32.4%
OTHER PROV./TOT REV	0.0%	0.0%	0.0%	0.0%	4.8%
ADMINS EXP/TOT REV	11.1%	5.6%	6.5%	4.8%	9.5%
MRKETING EXP/TOT REV	2.9%	1.5%	1.7%	2.2%	1.7%
ENERGY COST/TOT REV	3.2%	1.8%	2.0%	2.4%	3.4%
P.O.M.E.C./TOT REV	7.0%	4.9%	6.8%	7.1%	5.1%
OTHER PROV/TOT REV	4.0%	4.0%	4.0%	6.7%	4.0%
	28.1%	17.9%	21.0%	23.2%	28.4%
G.O.P	17.3%	45.9%	42.4%	45.3%	39.2%



TABLE (6.29)  
ASWAN OBEROI HOTEL  
PERCENTAGE BREAKDOWN  
OF COSTS & REVENUES  
1989

ROOMS DEPARTMENT		
L.E.	1989	%
GROSS REVENUE	6864956	100.1%
LESS ALLOWANCES & DISCOUNTS	-7253	-0.1%
	-----	-----
NET REVENUE	6857703	100.0%
	-----	-----
LESS COSTS		
SALARIES	207047	3.0%
EMPLOYEE MEALS	104114	1.5%
EXTRA SALARIES	119911	1.7%
	-----	-----
	431072	6.3%
LESS OTHER EXPENSES		
LAUNDRY	73190	1.1%
TRAVEL AGENTS COMMISSION	138378	2.0%
TRANSPORT	5041	0.1%
EMPLOYEE CLOTHING	2342	0.0%
LINENWEAR	2118	0.0%
CLEANING SUPPLIES	37854	0.6%
GUEST SUPPLIES	166681	2.4%
STATIONARY	14544	0.2%
NEWSPAPERS	6560	0.1%
TRAVEL	5009	0.1%
SUNDRY EXPENSES	7626	0.1%
DECORATIONS	6709	0.1%
LICENSES	5268	0.1%
EMPLOYEE HOUSING	16319	0.2%
TEL & TLX & POST	26884	0.4%
MUSIC	10000	0.1%
OTHERS	12666	0.2%
	-----	-----
	537189	7.8%
TOTAL COSTS	968261	14.1%
ROOMS DEPARTMENT PROFIT	5889442	85.9%

TABLE (6.30)  
ASWAN OBEROI HOTEL  
PERCENTAGE BREAKDOWN  
OF COSTS & REVENUES  
1989

F&B DEPARTMENT		
L.E.	1989	%
F&B REVENUES	5084439	100.7%
LESS ALLOWANCES & DISCOUNTS	-36270	-0.7%
	-----	-----
NET F&B REVENUE	5048169	100.0%
LESS COST OF SALES		
FOOD COST	1274486	25.2%
BEVERAGE COST	321471	6.4%
	-----	-----
	1595957	31.6%
LESS COSTS		
SALARIES	448726	8.9%
EMPLOYEE MEALS	129788	2.6%
OTHERS	127895	2.5%
	-----	-----
	706409	14.0%
LESS OTHER EXPENSES		
LAUNDRY	43028	0.9%
F&B MENUES	16403	0.3%
STATIONARY	5175	0.1%
CLEANING SUPPLIES	39364	0.8%
GUEST SUPPLIES	16911	0.3%
PAPER SUPPLIES	13896	0.3%
EMPLOYEE CLOTHING	691	0.0%
MUSIC	43783	2.8%
KITCHEN SUPPLIES	17205	0.3%
FUEL FOR KITCHEN	64200	1.3%
BREAKAGE	2471	0.0%
DECORATIONS	1464	0.0%
SUNDRY EXPENSES	4419	0.1%
TRANSPORT	5885	0.1%
LINENWEAR	586	0.0%
LICENSES	571	0.0%
TEL & TLX & POST	19	0.0%
EMPLOYEE HOUSING	23419	0.5%
WAREHOUSING	17624	0.3%
GUEST CHECKS	10639	0.2%
TRAVEL	11416	0.2%
PARTIES EXPENSES	8415	0.2%
	-----	-----
	447584	8.9%
TOTAL COSTS	2749950	54.5%
F&B DEPARTMENT PROFIT	2298219	45.5%

TABLE (6.31)  
ASWAN OBEROI HOTEL  
PERCENTAGE BREAKDOWN  
OF COSTS & REVENUES  
1989

L.E.	TEL & TLX DEPARTMENT	
	1989	%
REVENUES	1889208	100.0%
	-----	-----
LESS COST OF SALES	1524591	80.7%
LESS OTHER EXPENSES		
EMPLOYEE MEALS	18892	0.0%
SALARIES	22671	1.0%
OTHERS	5667	1.2%
	-----	-----
	47230	2.2%
TOTAL COSTS	1571821	82.9%
TELEPHONE & TELEX DEPT PROFIT	317387	17.1%



TABLE (6.32)  
ASWAN OBEROI HOTEL  
PERCENTAGE BREAKDOWN  
OF COSTS & REVENUES  
1989

L.E.	LAUNDRY DEPARTMENT	
	1989	%
REVENUES	53858	103.9%
LESS ALLOWANCES & DISCOUNTS	-2015	-3.9%
	-----	-----
	51843	100.0%
	-----	-----
LESS COST OF SALES	8778	16.9%
LAUNDRY DEPARTMENT PROFIT	43065	83.1%

TABLE (6.33)  
 ASWAN OBEROI HOTEL  
 PERCENTAGE BREAKDOWN  
 OF COSTS & REVENUES  
 1989

L.E.	CIGARETTES SECTION	
	1989	%
REVENUES	15340	100.0%
	-----	-----
COST OF SALES	8733	56.9%
CIGARETTES PROFIT	6607	43.1%

TABLE (6.34)  
ASWAN OBEROI HOTEL  
PERCENTAGE BREAKDOWN  
OF COSTS & REVENUES  
1989

HEALTH CENTER		
L.E.	1989	%
NET REVENUES	87794	100.0%
	-----	-----
LESS COSTS		
EMPLOYEE MEALS	4293	4.9%
SALARIES	5040	5.7%
	-----	-----
	9333	10.6%
LESS OTHER EXPENSES		
SWIMMING POOL SUPPLIES	197	0.2%
TRAVEL	99	0.1%
EMPLOYEES HOUSING	4141	4.7%
TRANSPORT	98	0.1%
	-----	-----
	4535	5.2%
TOTAL EXPENSES	13868	15.8%
HEALTH CENTER PROFIT	73926	84.2%



TABLE (6.35)  
ASWAN OBEROI HOTEL  
PERCENTAGE BREAKDOWN  
OF REVENUES  
1989

L.E.	RENTALS & OTHER INCOME	
	1989	%
GIFT SHOPS	24883	12.6%
BANQUE DE CAIRE	3992	2.0%
LIBRARY	13200	6.7%
PAPARYUS	20400	10.4%
LEATHER SHOP	30600	15.5%
GOLD	44400	22.6%
SILVER & COPPER	25200	12.8%
PERFUMERY	19800	10.1%
THOMAS COOK	14400	7.3%
	-----	-----
	196875	100.0%
	-----	-----

TABLE (6.36)  
BASIC ASSUMPTIONS

NO. OF DAYS	365	365	365	365	365
NO. OF ROOMS	160	160	160	160	160
AVERAGE ROOM RATE	250.00	312.50	390.63	488.28	610.35
OCCUPANCY RATE	0.75	0.75	0.8	0.8	0.8
AVAIAABLE ROOMS	58400	58400	58400	58400	58400
OCCUPIED ROOMS	43800	43800	46720	46720	46720

CASH FLOW PROJECTION  
ASWAN OBEROI HOTEL

	1993	1994	1995	1996	1997
REVENUES:	20467290	25584112	34112150	42640187	53300234
ROOM	10950000	13687500	18250000	22812500	28515625
FOOD & BEVERAGE	7777570	9721963	12962617	16203271	20254089
TELEPHONE & TELEX	511682	639603	852804	1066005	1332506
OTHER INCOME	204673	255841	341121	426402	533002
RENTALS	1023364	1279206	1705607	2132009	2665012
TOTAL REVENUES	20467290	25584112	34112150	42640187	53300234
OPERATING COSTS	6344860	7931075	10574766	13218458	16523072
TOTAL COSTS	6344860	7931075	10574766	13218458	16523072
OVERHEAD COSTS					
GENERAL & ADM EXP	1023364	1279206	1705607	2132009	2665012
MKTG & ADV	409346	511682	682243	852804	1066005
ENERGY COSTS	716355	895444	1193925	1492407	1865508
P.O.M.E.C.	818692	1023364	1364486	1705607	2132009
REPLACEMENT PROVIS.	818692	1023364	1364486	1705607	2132009
TOTAL EXPENSES	3786449	4733061	6310748	7888435	9860543
G.O.P.	10335981	12919977	17226636	21533294	26916618
G.O.P./REVENUES	50.5%	50.5%	50.5%	50.5%	50.5%
MANAGEMENT FEES	1653757	2067196	2756262	3445327	4306659
NET OWNER'S PROFIT	8682224	10852780	14470374	18087967	22609959
NPV METHOD	107794698	L.E.		\$ 32177522	

TABLE (6.37)  
SENSITIVITY ANALYSIS  
CAIRO MARRIOTT HOTEL

A.	RISK PREMIUM ( $E(R_m) - R_f$ )	DISCOUNT RATE (k)	NPV L.E. billion
xx	3%	16.3%	1.63
	4%	16.8%	1.60
	5%	17.3%	1.57
B.	TOURISM BETA ( $B_j$ )		
	0.75	15.9%	1.65
xx	1.00	16.3%	1.63
	1.25	16.7%	1.61
C.	RISKLESS RATE ( $R_f$ )		
	15%	14.8%	1.72
	17%	15.8%	1.66
xx	18%	16.3%	1.63
D.	AVERAGE ROOM RATE		
	350 L.E.	16.3%	1.59
xx	375 L.E.	16.3%	1.63
	400 L.E.	16.3%	1.67
E.	OCCUPANCY RATES IN LAST TWO YEARS		
	75%	16.3%	1.61
xx	80%	16.3%	1.63
	85%	16.3%	1.65

N.B.: xx represents our original case



TABLE (6.38)  
SENSITIVITY ANALYSIS  
CAIRO SHERATON HOTEL

A.	RISK PREMIUM ( $E(R_m) - R_f$ )	DISCOUNT RATE (k)	NPV L.E. million
	3%	17.3%	569
	4%	16.8%	558
xx	5%	17.3%	549
B.	TOURISM BETA ( $B_j$ )		
	0.75	16.7%	561
xx	1.00	17.3%	549
	1.25	17.9%	537
C.	RISKLESS RATE ( $R_f$ )		
	15%	15.8%	579
	17%	16.8%	558
xx	18%	17.3%	549
D.	AVERAGE ROOM RATE		
	250 L.E.	17.3%	528
xx	275 L.E.	17.3%	549
	300 L.E.	17.3%	569
E.	OCCUPANCY RATES IN LAST TWO YEARS		
xx	80%	17.3%	549
	85%	17.3%	554
	90%	17.3%	560

N.B.: xx represents our original case

TABLE (6.39)  
SENSITIVITY ANALYSIS  
ASWAN OBEROI HOTEL

A.	RISK PREMIUM ( $E(R_m) - R_f$ )	DISCOUNT RATE (k)	NPV L.E. million
	4%	16.8%	116
	5%	17.3%	112
xx	6%	17.8%	108
B.	TOURISM BETA ( $B_j$ )		
	0.75	17.0%	114
xx	1.00	17.8%	108
	1.25	18.6%	102
C.	RISKLESS RATE ( $R_f$ )		
	15%	16.3%	120
	17%	17.3%	112
xx	18%	17.8%	108
D.	AVERAGE ROOM RATE		
	225 L.E.	17.8%	103
xx	250 L.E.	17.8%	108
	275 L.E.	17.8%	112
E.	OCCUPANCY RATES IN LAST TWO YEARS		
	75%	17.8%	107
xx	80%	17.8%	108
	85%	17.8%	109

N.B.: xx represents our original case

Table (7.1)  
CAIRO STOCK EXCHANGE  
DAILY STOCK INDEX FOR ALL SECTORS  
YEARS 1989 AND 1990

MONTH	DAY	LINK(t)	INDEX(t)
BASE 8/1/89			
JAN 89	8	100.00	100.00
	9	99.93	99.93
	10	100.05	100.05
	11	99.98	99.98
	12	100.02	100.02
	15	100.64	100.64
	16	104.25	104.25
	17	101.07	101.07
	18	101.37	101.37
	19	100.33	100.33
	22	100.01	100.01
	23	100.85	100.85
	24	104.08	104.08
	25	100.60	100.60
	26	100.76	100.76
	29	100.58	100.58
	30	101.47	101.47
	31	100.49	100.49
FEB 1989	1	98.70	98.70
	2	100.11	100.11
	5	103.63	103.63
	6	100.06	100.06
	7	98.57	98.57
	8	101.00	101.00
	9	101.07	101.07
	12	99.30	99.30
	13 *	100.00	99.46
	14	99.83	99.29
	15	99.21	98.67
	19	99.09	98.55
	20	100.08	99.54
	21	100.07	99.53
	22	99.98	99.44
	23	99.67	99.13
	26	99.05	98.52
	27	99.14	98.60
	28	99.90	99.36
MAR 1989	1	99.36	98.82
	2	100.11	99.57
	5	99.97	99.43
	6	99.64	99.10
	7	100.57	100.03
	8	99.93	99.39
	9	100.24	99.70
	12	99.66	99.12
	13	100.14	99.60



	14 *	100.00	99.29
	15	99.13	98.43
	16	100.02	99.31
	19	99.08	98.38
	20	98.74	98.04
	22	99.78	99.07
	23	99.12	98.42
	26	100.26	99.55
	27	100.02	99.31
	28	100.17	99.46
	29	99.02	98.32
APR 1989	30	99.82	99.11
	2	99.74	99.03
	3	98.75	98.05
	4	100.14	99.43
	5	99.05	98.35
	6	100.35	99.64
	9	99.91	99.20
	10	100.10	99.39
	11	98.56	97.86
	12 *	100.00	99.72
	13	99.31	99.03
	16	99.69	99.41
	17	99.92	99.64
	18	99.89	99.61
	19	99.74	99.46
	20	99.43	99.15
	24	99.78	99.50
	26	99.51	99.23
	27	99.76	99.48
MAY 1989	2	99.71	99.43
	3	99.26	98.98
	4	99.28	99.00
	8	99.58	99.30
	9	98.85	98.57
	10	99.38	99.10
	11 *	100.00	98.99
	14	99.83	98.82
	15	99.98	98.97
	16	99.73	98.72
	17	99.88	98.87
	18	105.49	104.42
	21	100.01	99.00
	22	99.97	98.96
	23	100.05	99.04
	24	100.06	99.05
	25	99.90	98.89
	28	99.93	98.92
	29	99.98	98.97
	30	99.98	98.97
	31	100.02	99.01
JUN 1989	1	100.36	99.35
	4	100.08	99.07
	5	100.20	99.19
	6	100.55	99.53
	7	100.95	99.93
	8	100.53	99.51
	11 *	100.00	100.67
	12	99.85	100.52
	13	99.92	100.59

	14	99.99	100.66
	15	100.13	100.80
	19	100.02	100.69
	20	99.94	100.61
	21	99.82	100.49
	22	99.41	100.08
	25	100.05	100.72
	26	99.99	100.66
	27	100.05	100.72
	28	99.94	100.61
JUL 1989	29	100.26	100.93
	2	99.72	100.39
	3	99.77	100.44
	4	100.10	100.77
	5	97.65	98.30
	6	99.86	100.53
	9	99.06	99.72
	10 *	100.00	99.59
	11	99.93	99.52
	16	99.90	99.49
	17	99.87	99.46
	18	99.83	99.42
	19	99.51	99.10
	20	99.96	99.55
	24	99.90	99.49
	25	99.90	99.49
	26	99.72	99.31
	27	99.64	99.23
	30	99.38	98.97
	31	99.08	98.67
AUG 1989	1	99.90	99.49
	2	99.52	99.11
	6	99.45	99.04
	7	99.30	98.89
	8 *	100.00	99.84
	9	99.99	99.83
	10	100.18	100.02
	13	99.49	99.33
	14	98.93	98.77
	15	98.90	98.74
	16	100.03	99.87
	17	99.05	98.89
	20	100.02	99.86
	21	99.18	99.02
	22	100.17	100.01
	23	99.93	99.77
	24	99.96	99.80
	27	100.06	99.90
	28	100.05	99.89
	29	99.48	99.32
	30	100.67	100.51
	31	100.18	100.02
SEP 1989	3	100.09	99.93
	4	99.32	99.16
	5	99.77	99.61
	6	100.14	99.98
	7	99.91	99.75
	10	99.35	99.19
	11	100.33	100.17
	12	99.92	99.76

	13 *	100.00	100.12
	14	99.98	100.10
	17	100.01	100.13
	18	100.02	100.14
	19	99.98	100.10
	20	99.86	99.98
	21	99.88	100.00
	24	98.40	98.52
	25	99.91	100.03
	26	99.92	100.04
	27	99.85	99.97
	28	100.01	100.13
OCT 1989	1	99.57	99.69
	2	99.17	99.29
	3	100.42	100.54
	4	100.11	100.23
	5	99.85	99.97
	8	99.78	99.90
	9	100.08	100.20
	10	100.39	100.51
	11	100.81	100.93
	15 *	100.00	99.91
	16	100.27	100.18
	17	100.40	100.31
	18	100.13	100.04
	19	100.17	100.08
	22	99.79	99.70
	23	100.28	100.19
	24	100.06	99.97
	25	99.87	99.78
	26	99.98	99.89
	29	99.85	99.76
	30	98.87	98.78
	31	98.78	98.69
NOV 1989	1	99.21	99.12
	2	100.33	100.24
	5	100.24	100.15
	6	98.72	98.63
	7	100.11	100.02
	8	99.17	99.08
	9	100.67	100.58
	12 *	100.00	99.39
	13	98.65	98.05
	14	99.90	99.29
	15	99.73	99.12
	16	98.91	98.31
	19	99.85	99.24
	20	100.15	99.54
	21	100.33	99.72
	22	100.29	99.68
	23	100.34	99.73
	26	100.45	99.84
	27	99.25	98.64
	28	100.43	99.82
	29	99.39	98.78
	30	100.42	99.81
DEC 1989	3	100.16	99.55
	4	99.39	98.78
	5	99.12	98.52
	6	100.63	100.02



	7	100.27	99.66
	10	100.49	99.88
	11 *	100.00	99.58
	12	100.11	99.69
	13	99.14	98.72
	14	99.22	98.80
	17	100.20	99.78
	18	99.94	99.52
	19	100.20	99.78
	20	99.02	98.60
	21	99.20	98.78
	24	100.20	99.78
	25	100.47	100.05
	26	100.26	99.84
	27	100.14	99.72
	28	100.08	99.66
	31	100.04	99.62
JAN 1990	2	100.73	100.31
	3	100.04	99.62
	4	100.14	99.72
	8	100.75	100.33
	9 *	100.00	100.85
	10	99.94	100.79
	11	101.10	101.96
	14	101.59	102.45
	15	100.86	101.72
	16	101.75	102.61
	17	100.66	101.52
	18	103.78	104.66
	21	101.55	102.41
	22	99.85	100.70
	23	100.43	101.28
	24	100.99	101.85
	25	102.47	103.34
	28	101.44	102.30
	29	101.39	102.25
	30	102.54	103.41
	31	102.27	103.14
FEB 1990	1	99.68	100.53
	4	100.14	100.99
	5	99.33	100.17
	6	98.94	99.78
	7	100.38	101.23
	8	98.71	99.55
	11	99.66	100.51
	12	99.11	99.95
	13	97.55	98.38
	14 *	100.00	100.01
	15	100.18	100.19
	18	99.19	99.20
	19	100.03	100.04
	20	100.13	100.14
	21	99.17	99.18
	22	99.98	99.99
	25	100.17	100.18
	26	100.35	100.36
	27	100.69	100.70
	28	99.67	99.68
	1	99.87	99.88
MAR 1990	4	100.62	100.63

	5	99.92	99.93
	6	100.04	100.05
	7	100.39	100.40
	8	101.30	101.31
	11	100.10	100.11
	12	101.44	101.45
	13	100.44	100.45
	14	101.80	101.81
	15 *	100.00	101.25
	18	100.36	101.61
	19	99.75	101.00
	20	99.42	100.66
	21	100.04	101.29
	22	100.60	101.86
	25	100.22	101.47
	26	100.77	102.03
	27	100.91	102.17
	28	99.93	101.18
	29	100.81	102.07
APR 1990	1	104.67	105.98
	2	104.91	106.22
	3	102.14	103.42
	4	104.27	105.57
	5	102.37	103.65
	9 *	100.00	99.94
	10	99.61	99.55
	11	99.69	99.63
	12	99.61	99.55
	17	99.28	99.22
	18	99.90	99.84
	19	99.24	99.18
	22	99.18	99.12
	23	97.78	97.72
	24	98.93	98.87
	29	102.86	102.80
	30	99.14	99.08
MAY 1990	2	100.08	100.02
	3	99.04	98.98
	6	99.07	99.01
	7	99.87	99.81
	8	99.80	99.74
	9	99.95	99.89
	10	100.07	100.01
	13	99.77	99.71
	14 *	100.00	99.83
	15	99.75	99.58
	16	100.09	99.92
	17	99.91	99.74
	20	100.51	100.34
	21	100.22	100.05
	22	100.56	100.39
	23	101.11	100.94
	24	101.13	100.96
	27	101.79	101.62
	28	100.10	99.93
	29	101.11	100.94
	30	102.06	101.89
	31	101.51	101.34
JUN 1990	3	101.55	101.38
	4	99.06	98.89

	5	100.78	100.61
	6	101.53	101.36
	7	101.89	101.72
	10	106.43	106.25
	11	100.61	100.44
	12 *	100.00	100.43
	13	99.93	100.36
	14	99.10	99.53
	17	100.30	100.73
	20	99.90	100.33
	21	99.27	99.70
	24	99.40	99.83
	25	99.91	100.34
	26	99.90	100.33
	27	99.70	100.13
	28	99.74	100.17
JUL 1990	4	100.05	100.48
	5	99.17	99.60
	8	99.32	99.75
	9	98.89	99.32
	10	99.14	99.57
	11 *	100.00	99.14
	12	99.96	99.10
	15	99.86	99.00
	16	100.05	99.19
	17	99.96	99.10
	18	100.16	99.30
	19	99.57	98.71
	22	100.33	99.47
	24	100.35	99.49
	25	100.17	99.31
	26	99.60	98.74
	29	100.18	99.32
	30	99.09	98.24
	31	100.09	99.23
AUG 1990	1	100.30	99.44
	2	100.16	99.30
	5	100.70	99.83
	6	100.25	99.39
	7	100.41	99.55
	8	99.96	99.10
	9 *	100.00	100.40
	12	99.96	100.36
	13	99.89	100.29
	14	99.75	100.15
	15	99.98	100.38
	16	99.80	100.20
	19	99.01	99.41
	20	99.79	100.19
	21	99.79	100.19
	22	99.88	100.28
	23	99.84	100.24
	26	100.09	100.49
	27	99.85	100.25
	28	100.00	100.40
	29	100.44	100.84
	30	99.37	99.77
SEP 1990	2	100.36	100.76
	3	100.63	101.03
	4	100.41	100.81



	5	100.05	100.45
	6	100.06	100.46
	9 *	100.00	99.86
	10	100.03	99.89
	11	100.01	99.87
	12	99.87	99.73
	13	99.98	99.84
	16	99.96	99.82
	17	100.23	100.09
	18	99.15	99.01
	19	99.40	99.26
	20	100.04	99.90
	23	99.80	99.66
	24	99.23	99.09
	25	100.54	100.40
	26	100.37	100.23
	27	101.03	100.89
	30	100.71	100.57
OCT 1990	1	103.18	103.04
	3	99.20	99.06
	4	105.37	105.22
	7	103.65	103.50
	8 *	100.00	104.06
	9	99.71	103.76
	10	99.88	103.94
	11	99.67	103.72
	14	99.35	103.38
	15	98.83	102.84
	16	99.46	103.50
	17	100.06	104.12
	18	99.55	103.59
	21	99.96	104.02
	22	100.05	104.11
	23	100.10	104.16
	24	99.19	103.22
	25	100.15	104.22
	28	100.13	104.20
	29	99.88	103.94
	30	99.67	103.72
	31	100.13	104.20
NOV 1990	1	100.37	104.45
	4	100.51	104.59
	5	100.17	104.24
	6	100.53	104.61
	7	100.28	104.35
	8	99.16	103.19
	11	100.14	104.21
	12	100.20	104.27
	13 *	100.00	100.31
	14	100.03	100.34
	15	100.07	100.38
	18	100.06	100.37
	19	100.32	100.63
	20	100.39	100.70
	21	99.85	100.16
	22	100.27	100.58
	25	100.27	100.58
	26	100.10	100.41
	27	100.42	100.73
	28	100.42	100.73

DEC 1990

29	100.14	100.45
2	100.77	101.08
3	99.99	100.30
4	100.08	100.39
5	100.13	100.44
6	100.20	100.51
9	100.22	100.53
10	101.38	101.69
11	101.57	101.88
12 *	100.00	101.79
13	100.12	101.91
16	99.27	101.05
17	99.91	101.70
18	99.22	101.00
19	98.32	100.08
20	98.83	100.60
23	99.83	101.62
24	99.96	101.75
25	100.17	101.96
26	98.20	99.96
27	98.58	100.34
30	100.61	102.41
31	100.30	102.10

Table (7.2)  
DAILY STOCK INDEX FOR TOURISM SECTOR  
YEARS 1989 AND 1990

MONTH	DAY	LINK(t)	INDEX(t)
BASE 8/1/89			
JAN 1989	8	100.00	100.00
	9	100.21	100.21
	10	101.58	101.58
	11	101.58	101.58
	12	100.30	100.30
	15	108.14	108.14
	16	100.49	100.49
	17	108.84	108.84
	18	112.82	112.82
	19	116.09	116.09
	22	122.05	122.05
	23	120.73	120.73
	24	118.29	118.29
	25	101.09	101.09
	26	115.59	115.59
	29	100.98	100.98
	30	115.17	115.17
FEB 1989	31	100.88	100.88
	1	99.74	99.74
	2	101.21	101.21
	5	101.21	101.21
	6	101.29	101.29
	7	101.29	101.29
	8	112.44	112.44
	9	111.69	111.69
	12	101.29	101.29
	13 *	100.00	109.46
	14	98.22	107.51
	15	100.00	109.46
	19	98.40	107.71
	20	100.18	109.66
	21	100.18	109.66
	22	100.18	109.66
	23	98.58	107.91
	26	98.46	107.77
	27	98.58	107.91
	28	98.58	107.91
MAR 1989	1	98.58	107.91
	2	98.46	107.77
	5	98.46	107.77
	6	97.03	106.21
	7	96.44	105.56
	8	95.85	104.92
	9	100.36	109.85
	12	95.13	104.13
	13	95.96	105.04
	14 *	100.00	93.96



	15	100.00	93.96
	16	100.00	93.96
	19	99.50	93.49
	20	99.85	93.82
	22	100.00	93.96
	23	99.87	93.84
	26	100.00	93.96
	27	100.00	93.96
	28	100.00	93.96
	29	97.98	92.06
APR 1989	30	95.46	89.69
	2	95.46	89.69
	3	95.46	89.69
	4	95.46	89.69
	5	95.46	89.69
	6	100.00	93.96
	9	99.81	93.78
	10	99.81	93.78
	11	95.46	89.69
	12 *	100.00	100.00
	13	97.40	97.40
	16	100.00	100.00
	17	97.40	97.40
	18	98.70	98.70
	19	97.01	97.01
	20	97.01	97.01
	24	97.01	97.01
	26	95.32	95.32
	27	95.32	95.32
MAY 1989	2	95.32	95.32
	3	95.32	95.32
	4	95.32	95.32
	8	94.15	94.15
	9	100.00	100.00
	10	93.49	93.49
	11 *	100.00	100.26
	14	99.32	99.58
	15	99.32	99.58
	16	99.32	99.58
	17	98.98	99.24
	18	100.00	100.26
	21	100.00	100.26
	22	99.32	99.58
	23	99.59	99.85
	24	99.59	99.85
	25	100.68	100.94
	28	101.36	101.62
	29	101.36	101.62
	30	101.91	102.17
	31	103.41	103.68
JUN 1989	1	106.14	106.42
	4	106.14	106.42
	5	106.14	106.42
	6	107.51	107.79
	7	108.73	109.01
	8	108.73	109.01
	11 *	100.00	100.00
	12	100.47	100.47
	13	100.00	100.00
	14	100.78	100.78
		384	

JUL 1989

AUG 1989

SEP 1989

15	100.78	100.78
19	100.78	100.78
20	100.78	100.78
21	99.19	99.19
22	99.13	99.13
25	99.13	99.13
26	99.13	99.13
27	99.13	99.13
28	99.13	99.13
29	99.13	99.13
2	100.00	100.00
3	97.67	97.67
4	100.00	100.00
5	99.22	99.22
6	97.67	97.67
9	96.98	96.98
10 *	100.00	96.05
11	96.98	93.15
16	96.98	93.15
17	99.62	95.69
18	100.00	96.05
19	100.19	96.23
20	100.19	96.23
24	100.19	96.23
25	98.29	94.41
26	98.29	94.41
27	100.00	96.05
30	100.19	96.23
31	97.91	94.04
1	97.09	93.25
2	100.19	96.23
6	96.64	92.82
7	97.50	93.65
8 *	100.00	97.67
9	99.79	97.46
10	99.19	96.88
13	99.19	96.88
14	99.51	97.19
15	100.00	97.67
16	100.73	98.38
17	101.07	98.72
20	100.24	97.90
21	100.70	98.35
22	100.97	98.62
23	100.89	98.54
24	100.16	97.83
27	100.16	97.83
28	101.54	99.17
29	101.22	98.86
30	100.71	98.36
31	100.00	97.67
3	100.00	97.67
4	100.10	97.77
5	99.92	97.59
6	99.92	97.59
7	100.00	97.67
10	100.00	97.67
11	99.85	97.52
12	101.46	99.10
13 *	100.00	99.84
	385	

OCT 1989

14	100.13	99.97
17	100.06	99.90
18	99.49	99.33
19	99.96	99.80
20	100.05	99.89
21	100.06	99.90
24	99.36	99.20
25	99.94	99.78
26	100.19	100.03
27	100.19	100.03
28	100.51	100.35
1	102.72	102.56
2	103.89	103.72
3	102.30	102.14
4	102.42	102.26
5	105.07	104.90
8	105.07	104.90
9	105.10	104.93
10	110.46	110.28
11	108.93	108.76
15 *	100.00	100.00
16	105.83	105.83
17	104.65	104.65
18	104.65	104.65
19	104.38	104.38
22	104.38	104.38
23	103.22	103.22
24	100.00	100.00
25	100.09	100.09
26	102.33	102.33
29	101.29	101.29
30	98.62	98.62
31	98.95	98.95

NOV 1989

1	98.25	98.25
2	99.55	99.55
5	99.55	99.55
6	100.58	100.58
7	100.09	100.09
8	100.58	100.58
9	101.17	101.17
12 *	100.00	100.09
13	100.00	100.09
14	100.00	100.09
15	100.00	100.09
16	99.16	99.25
19	101.40	101.49
20	101.40	101.49
21	101.50	101.59
22	101.50	101.59
23	101.50	101.59
26	100.10	100.19
27	100.10	100.19
28	100.10	100.19
29	101.50	101.59
30	101.50	101.59
3	100.10	100.19
4	100.10	100.19
5	100.10	100.19
6	100.00	100.09
7	100.00	100.09

DEC 1989



JAN 1990

FEB 1990

MAR 1990

10	100.00	100.09
11 *	100.00	100.00
12	100.00	100.00
13	100.00	100.00
14	100.00	100.00
17	100.00	100.00
18	100.00	100.00
19	100.00	100.00
20	98.86	98.86
21	98.86	98.86
24	98.86	98.86
25	98.86	98.86
26	98.86	98.86
27	100.23	100.23
28	100.23	100.23
31	100.00	100.00
2	100.00	100.00
3	100.00	100.00
4	100.00	100.00
8	100.00	100.00
9 *	100.00	100.00
10	99.89	99.89
11	99.79	99.79
14	100.00	100.00
15	100.00	100.00
16	100.00	100.00
17	100.00	100.00
18	100.00	100.00
21	100.00	100.00
22	75.61	75.61
23	100.00	100.00
24	78.64	78.64
25	79.20	79.20
28	100.00	100.00
29	80.56	80.56
30	100.33	100.33
31	100.33	100.33
1	100.00	100.00
4	100.00	100.00
5	100.00	100.00
6	92.09	92.09
7	103.89	103.89
8	88.74	88.74
11	93.24	93.24
12	89.71	89.71
13	90.04	90.04
14 *	100.00	100.00
15	99.87	99.87
18	99.49	99.49
19	97.91	97.91
20	97.91	97.91
21	97.86	97.86
22	98.56	98.56
25	98.56	98.56
26	98.04	98.04
27	100.00	100.00
28	97.84	97.84
1	97.39	97.39
4	98.78	98.78
5	96.48	96.48

	6	97.10	97.10
	7	97.84	97.84
	8	97.84	97.84
	11	100.20	100.20
	12	96.73	96.73
	13	96.73	96.73
	14	96.73	96.73
	15 *	100.00	100.00
	18	98.66	98.66
	19	98.50	98.50
	20	98.97	98.97
	21	98.97	98.97
	22	98.97	98.97
	25	98.97	98.97
	26	100.15	100.15
	27	102.21	102.21
	28	104.01	104.01
	29	100.00	100.00
APR 1990	1	100.31	100.31
	2	100.31	100.31
	3	100.31	100.31
	4	100.31	100.31
	5	102.98	102.98
	9 *	100.00	100.00
	10	98.80	98.80
	11	100.00	100.00
	12	99.10	99.10
	17	96.81	96.81
	18	95.31	95.31
	19	95.01	95.01
	22	95.38	95.38
	23	95.01	95.01
	24	95.61	95.61
	29	95.61	95.61
	30	95.61	95.61
MAY 1990	2	100.00	100.00
	3	95.61	95.61
	6	96.06	96.06
	7	95.86	95.86
	8	95.86	95.86
	9	95.86	95.86
	10	95.96	95.96
	13	95.15	95.15
	14 *	100.00	95.21
	15	99.94	95.15
	16	99.79	95.01
	17	99.17	94.42
	20	100.00	95.21
	21	100.00	95.21
	22	99.17	94.42
	23	99.73	94.95
	24	99.61	94.84
	27	100.00	95.21
	28	100.16	95.36
	29	98.75	94.02
	30	98.75	94.02
	31	98.40	93.69
JUN 1990	3	98.75	94.02
	4	98.75	94.02
	5	97.96	93.27

	6	98.34	93.63
	7	98.13	93.43
	10	98.29	93.58
	11	98.29	93.58
	12 *	100.00	100.16
	13	98.90	99.06
	14	98.31	98.47
	17	98.35	98.51
	20	100.00	100.16
	21	97.00	97.16
	24	98.35	98.51
	25	98.94	99.10
	26	98.73	98.89
	27	100.00	100.16
	28	100.00	100.16
JUL 1990	4	100.00	100.16
	5	98.73	98.89
	8	98.67	98.83
	9	98.73	98.89
	10	98.73	98.89
	11 *	100.00	98.73
	12	100.00	98.73
	15	100.00	98.73
	16	100.00	98.73
	17	100.64	99.36
	18	100.86	99.58
	19	100.92	99.64
	22	101.16	99.88
	24	101.16	99.88
	25	100.00	98.73
	26	100.00	98.73
	29	101.11	99.83
	30	101.93	100.64
	31	102.44	101.14
AUG 1990	1	102.48	101.18
	2	102.48	101.18
	5	102.57	101.27
	6	103.00	101.69
	7	103.21	101.90
	8	103.42	102.11
	9 *	100.00	103.21
	12	99.82	103.02
	13	99.82	103.02
	14	100.00	103.21
	15	99.82	103.02
	16	99.82	103.02
	19	99.74	102.94
	20	99.45	102.64
	21	98.90	102.07
	22	99.73	102.93
	23	99.10	102.28
	26	97.44	100.57
	27	97.44	100.57
	28	96.07	99.15
	29	96.16	99.25
	30	96.16	99.25
SEP 1990	2	96.16	99.25
	3	96.16	99.25
	4	96.62	99.72
	5	96.88	99.99



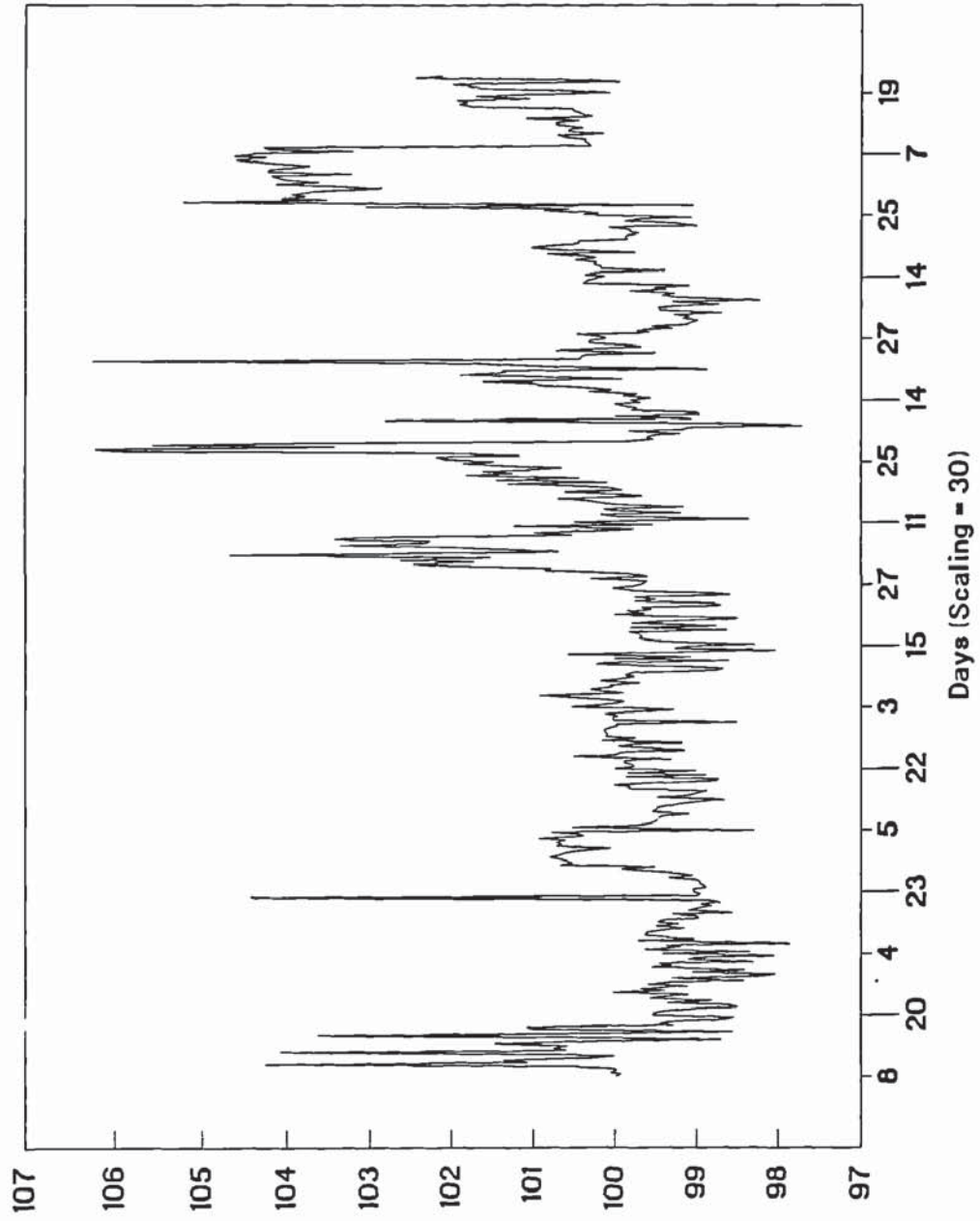
	6	96.69	99.79
	9 *	100.00	96.47
	10	100.00	96.47
	11	100.07	96.54
	12	100.07	96.54
	13	100.00	96.47
	16	100.00	96.47
	17	100.00	96.47
	18	99.52	96.01
	19	99.33	95.82
	20	99.33	95.82
	23	98.78	95.29
	24	98.58	95.10
	25	98.58	95.10
	26	97.41	93.97
	27	97.41	93.97
	30	97.65	94.20
OCT 1990	1	97.56	94.12
	3	97.88	94.42
	4	97.28	93.85
	7	97.28	93.85
	8 *	100.00	96.72
	9	99.31	96.05
	10	99.31	96.05
	11	99.31	96.05
	14	98.47	95.24
	15	96.30	93.14
	16	97.19	94.00
	17	97.19	94.00
	18	98.19	94.97
	21	98.28	95.06
	22	100.00	96.72
	23	100.00	96.72
	24	98.11	94.89
	25	98.09	94.87
	28	98.05	94.83
	29	98.28	95.06
	30	98.28	95.06
	31	98.47	95.24
NOV 1990	1	98.86	95.62
	4	98.84	95.60
	5	98.74	95.50
	6	98.74	95.50
	7	99.05	95.80
	8	99.05	95.80
	11	99.05	95.80
	12	99.05	95.80
	13 *	100.00	99.05
	14	100.00	99.05
	15	100.00	99.05
	18	100.00	99.05
	19	101.92	100.95
	20	101.84	100.87
	21	101.84	100.87
	22	101.15	100.19
	25	101.15	100.19
	26	101.15	100.19
	27	101.15	100.19
	28	100.96	100.00
	29	100.96	100.00
	390		

DEC 1990

2	101.15	100.19
3	101.15	100.19
4	101.46	100.50
5	101.46	100.50
6	101.46	100.50
9	101.46	100.50
10	101.92	100.95
11	101.92	100.95
12 *	100.00	101.88
13	100.00	101.88
16	100.00	101.88
17	100.00	101.88
18	100.00	101.88
19	100.00	101.88
20	99.97	101.85
23	99.97	101.85
24	99.97	101.85
25	99.97	101.85
26	99.71	101.58
27	99.71	101.58
30	100.09	101.97
31	100.14	102.02

# Graph (7.1) Daily Cairo All Share Index

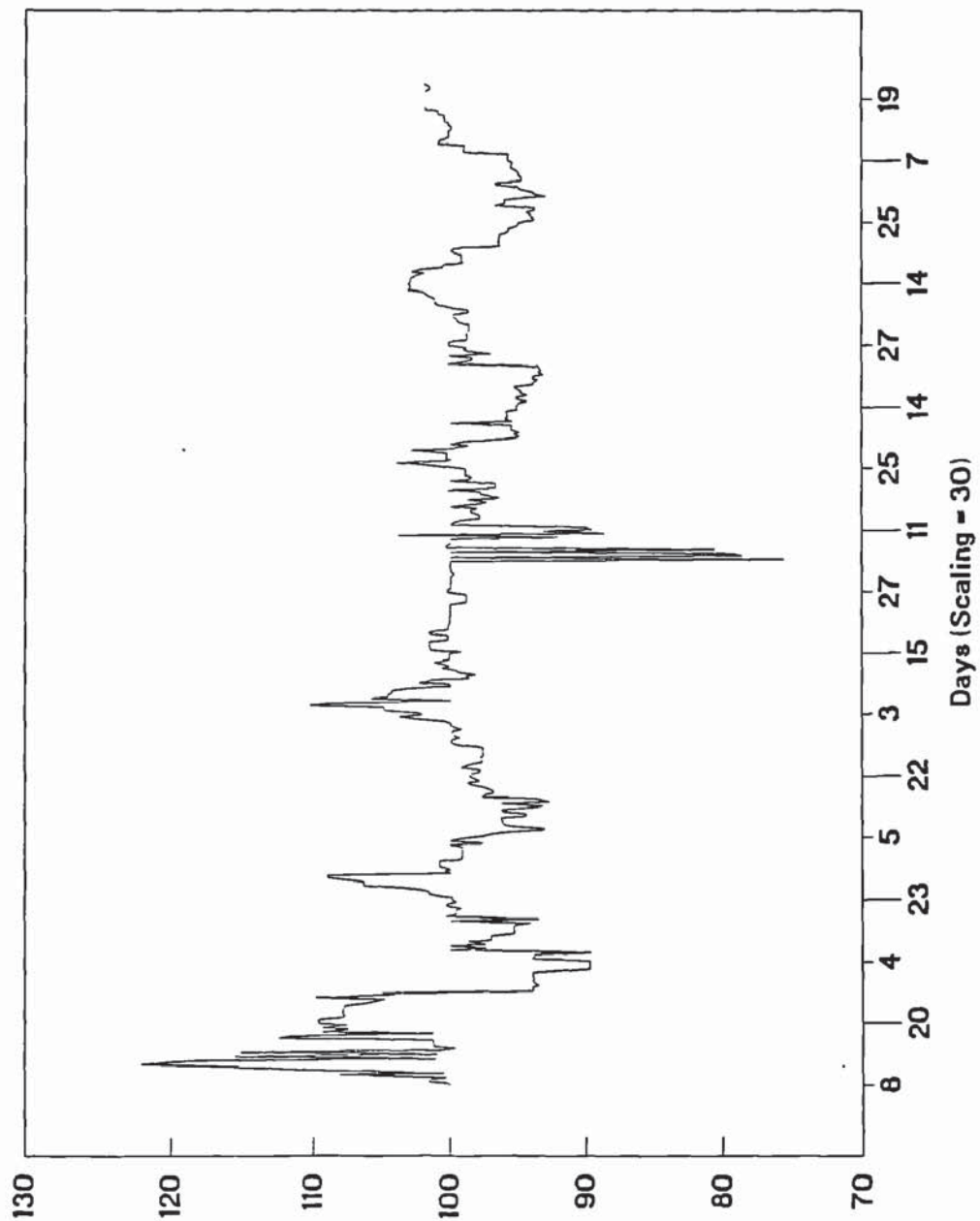
Years 1989 & 1990





## Graph (7.2) Daily Tourism Index

Years 1989 & 1990



Tourism Index

Table (7.3)

Regression Model between CASI and Tourism Index  
Minitab Software Results

Regression Equation:

$$\text{Tourism} = 120 - 0.212 \text{ Market}$$

Predictor	Coef	Stdev	t-ratio	p-value
Constant	120.38	14.61	8.24	0
Market	-0.2115	0.1457	-1.45	0.147

s = 4.741      R-sq = 0.4%      R-sq(adj) = 0.2%

Correlation between Market and Tourism Indexes is -0.066

Table (7.4)

MOST VOLATILE DAY FOR WHOLE MARKET  
1989 AND 1990

	SUN	MON	TUE	WED	THU
MEAN	100.44	100.24	100.27	100.19	100.38
STD	1.60	1.56	1.34	1.36	1.47

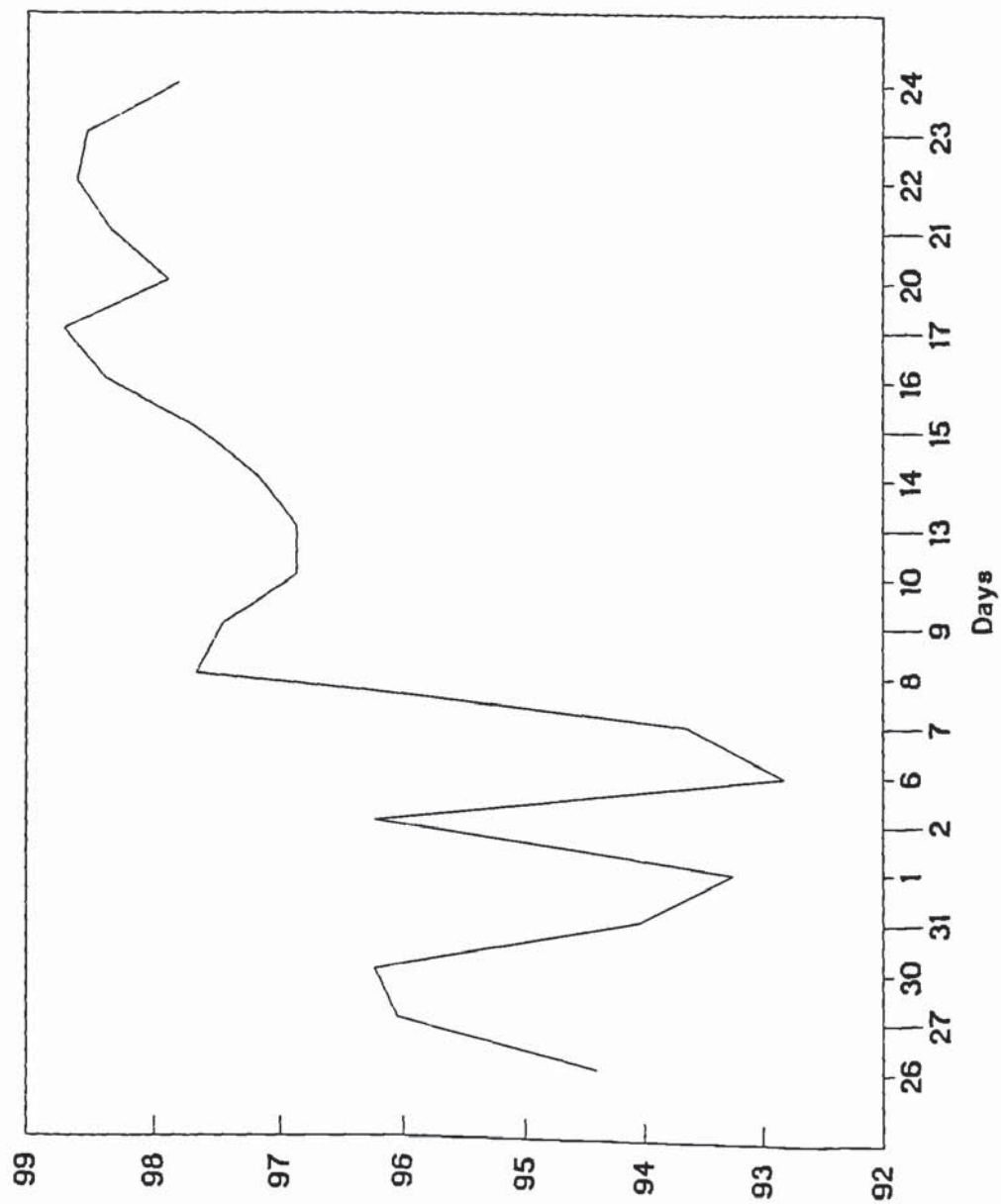
MOST VOLATILE DAY FOR TOURISM SECTOR  
1989 AND 1990

	SUN	MON	TUE	WED	THU
MEAN	99.23	98.83	99.32	99.28	99.22
STD	4.23	5.50	4.47	4.56	4.92



# Graph (7.3) 10 days before & after E1

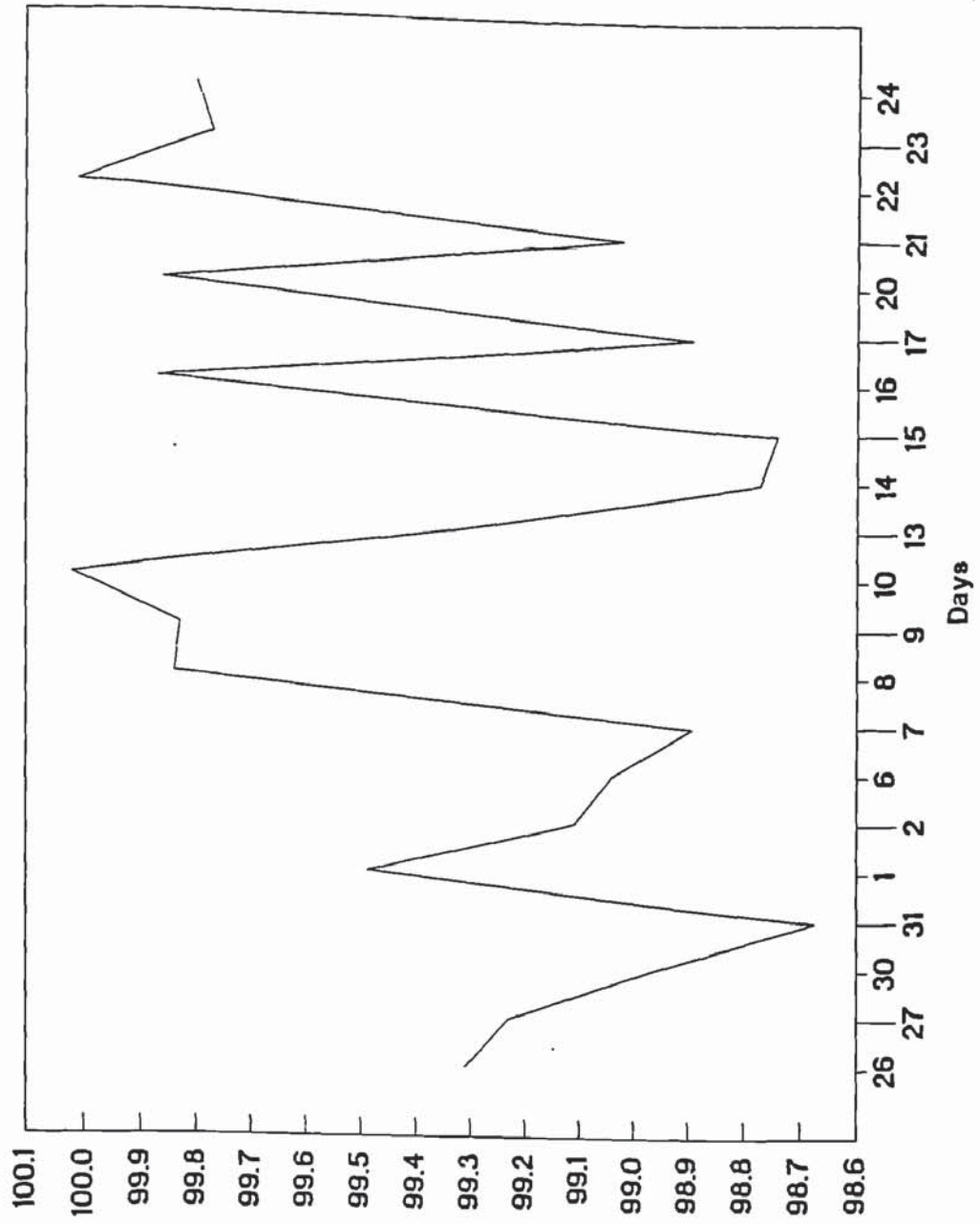
On 10/8/89, its effect on Tourism Index



Tourism Index

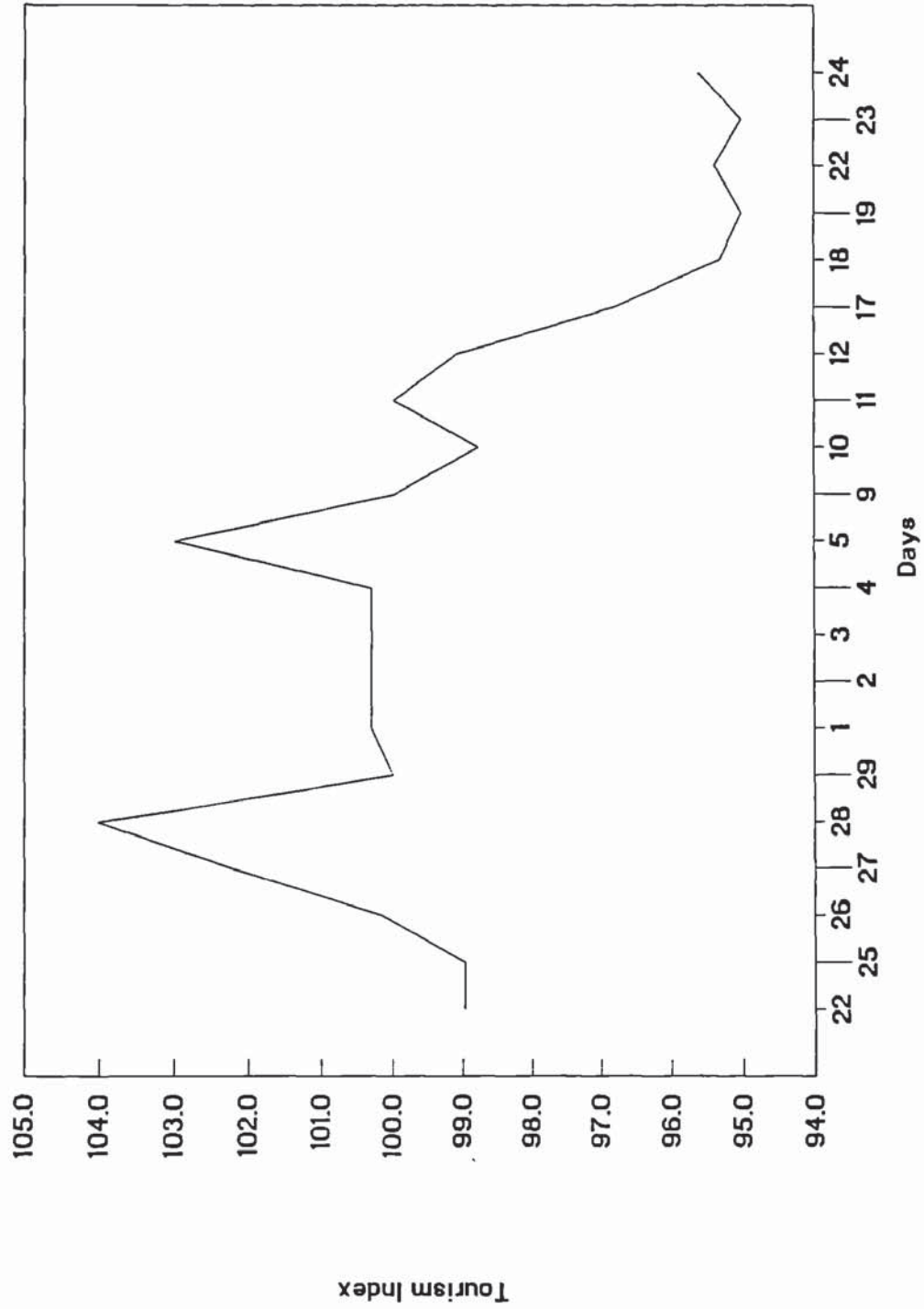
# Graph (7.4) Ten days before & after E1

On 10/8/89, its effect on CASI



## Graph (7.5) Ten days before & after E2

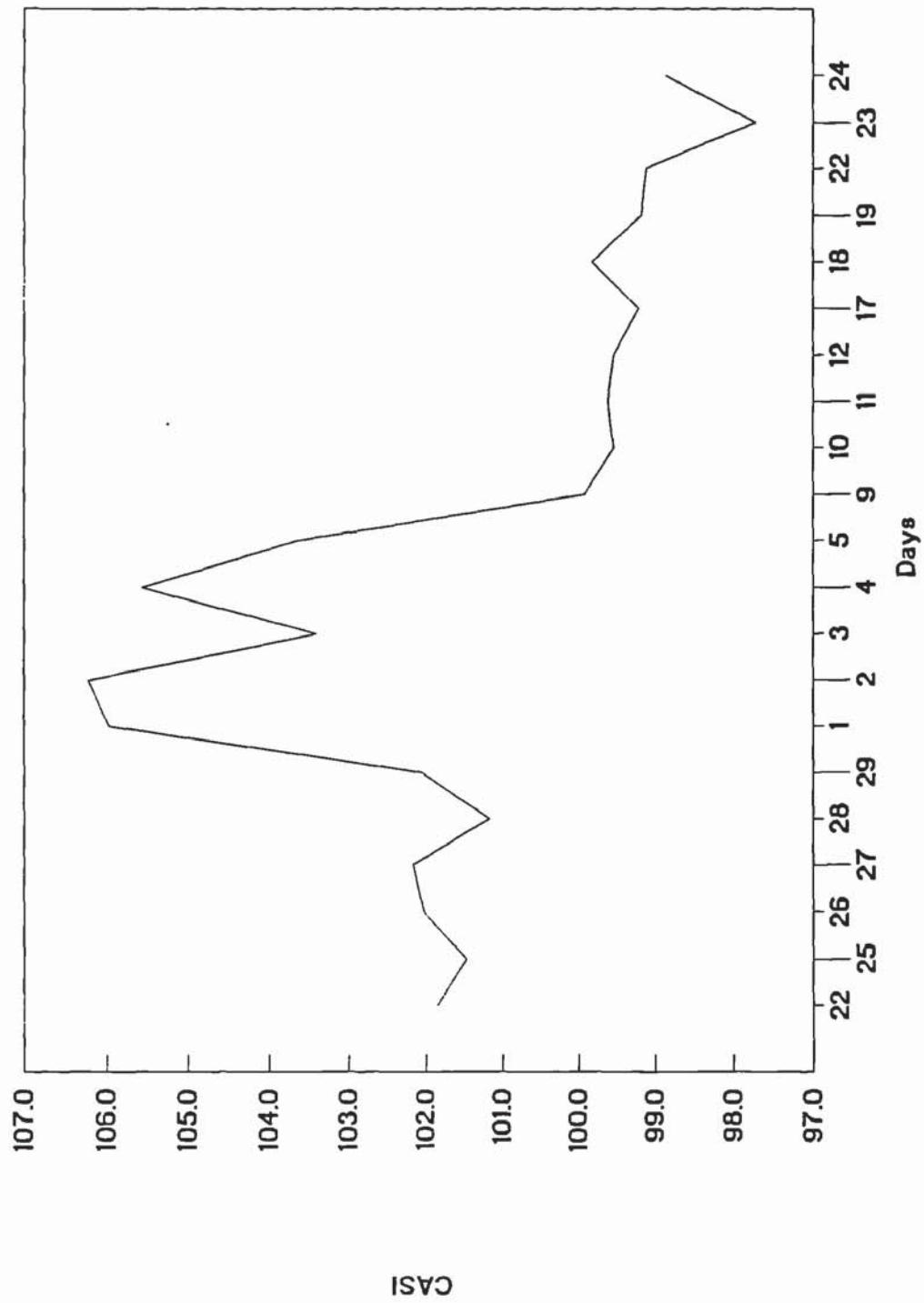
On 5/4/90, its effect on Tourism index





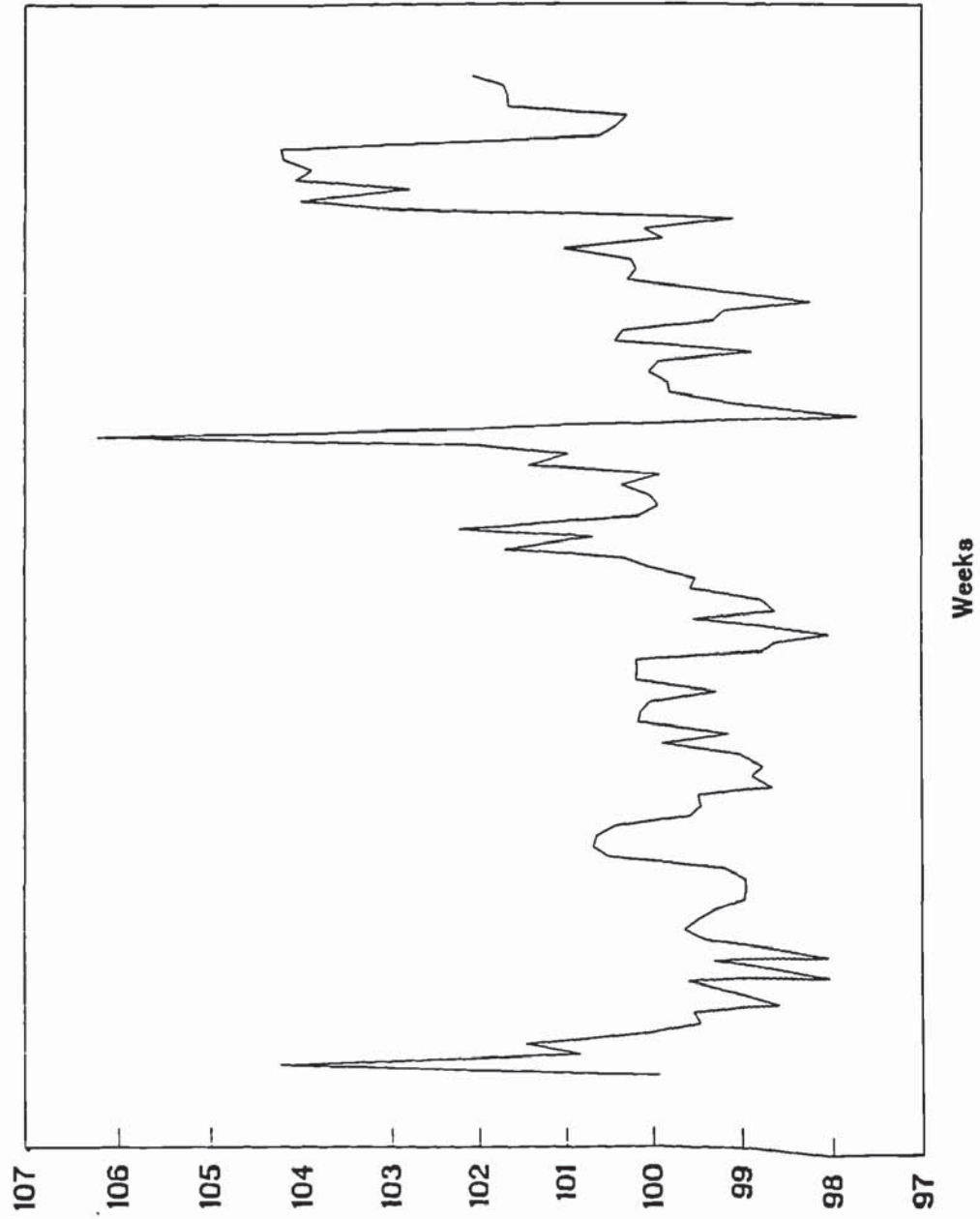
## Graph (7.6) 10 days before & after E2

On 5/4/90, its effect on CASI



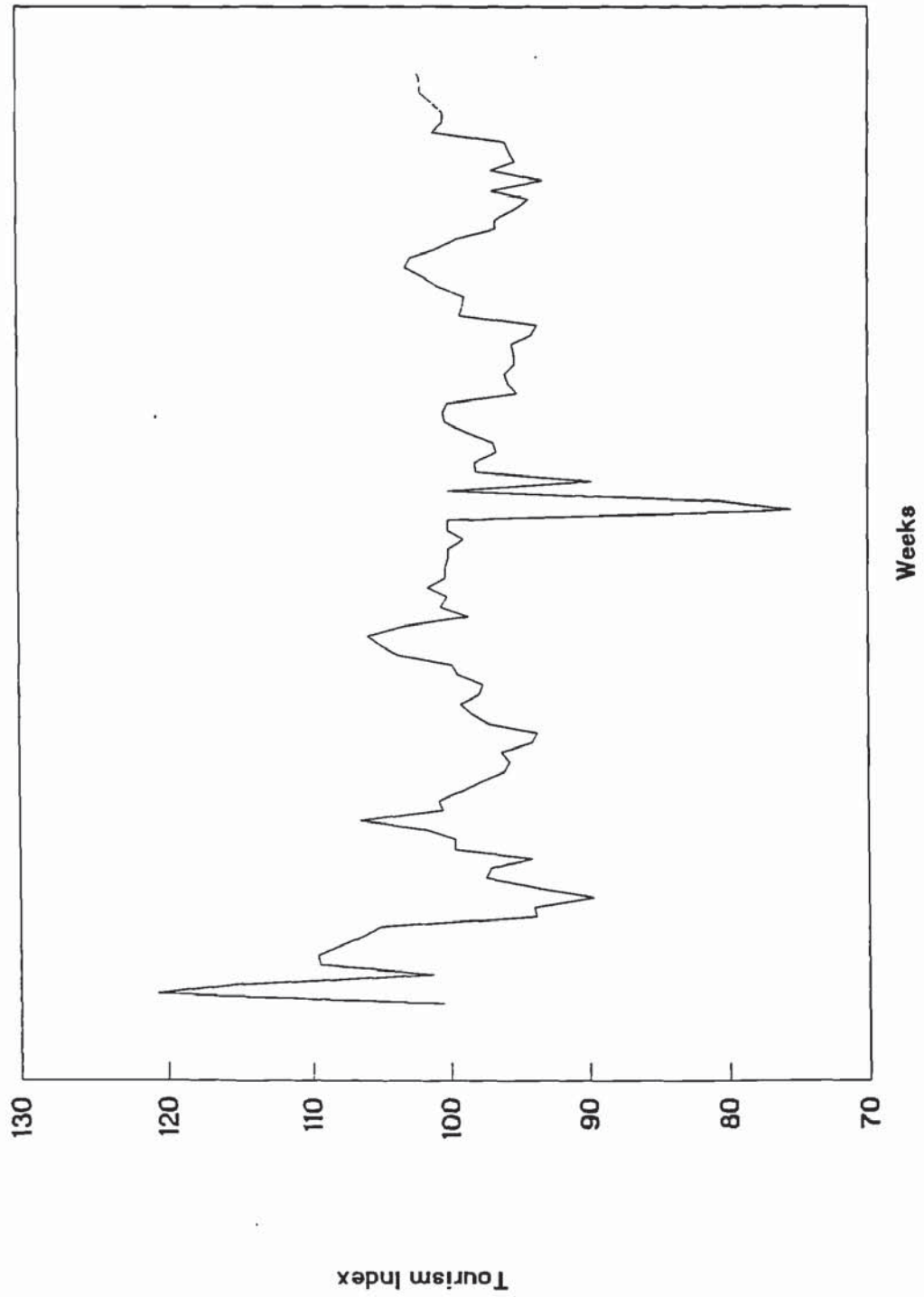
**Graph 7.7 Weekly CASI (Monday)**

Years 1989 and 1990



**Graph 7.8 Weekly Tourism Index (Monday)**

Years 1989 and 1990





**Table (7.5)**

```

DATASTREAM 301S                                21/ 9/92   16:46

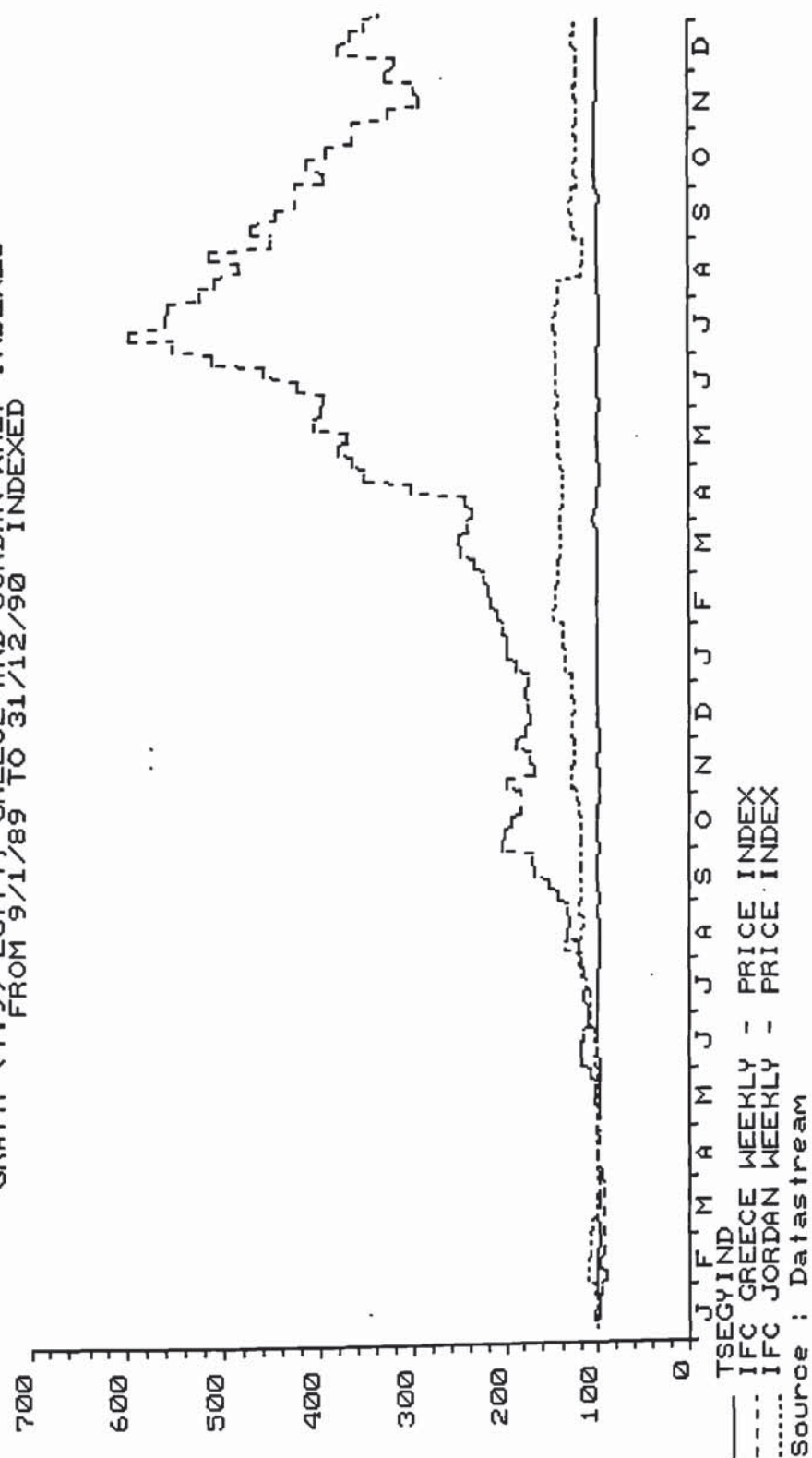
BASE SERIES IS  TSEGYIND
FREQUENCY = W      REGRESSION TYPE = LINEAR      LAST VALUE = 102.10
FROM 9/ 1/89 TO 31/12/90

TITLES:
LAST  REGRSN  STD  CORR  R
VALUE COEFF  ERROR COEFF SQUARED
IFC VENEZUELA WEEKLY - PRICE INDEX  3270.80 0.00101 0.00017 0.50383 0.25385
IFC INDIA WEEKLY - PRICE INDEX      345.910 0.01122 0.00200 0.47406 0.22473
FTA ALL SHARE - PRICE INDEX         1032.25 -0.0084 0.00215 0.34542 0.11932
IFC PORTUGAL WEEKLY - PRICE INDEX    396.940 -0.0062 0.00166 0.33305 0.11092
IFC TURKEY WEEKLY - PRICE INDEX       698.560 0.00109 0.00035 0.27864 0.07764
IFC GREECE WEEKLY - PRICE INDEX      655.010 0.00111 0.00053 0.17762 0.03155
IFC JORDAN WEEKLY - PRICE INDEX      153.100 0.00907 0.00797 0.05112 0.00261

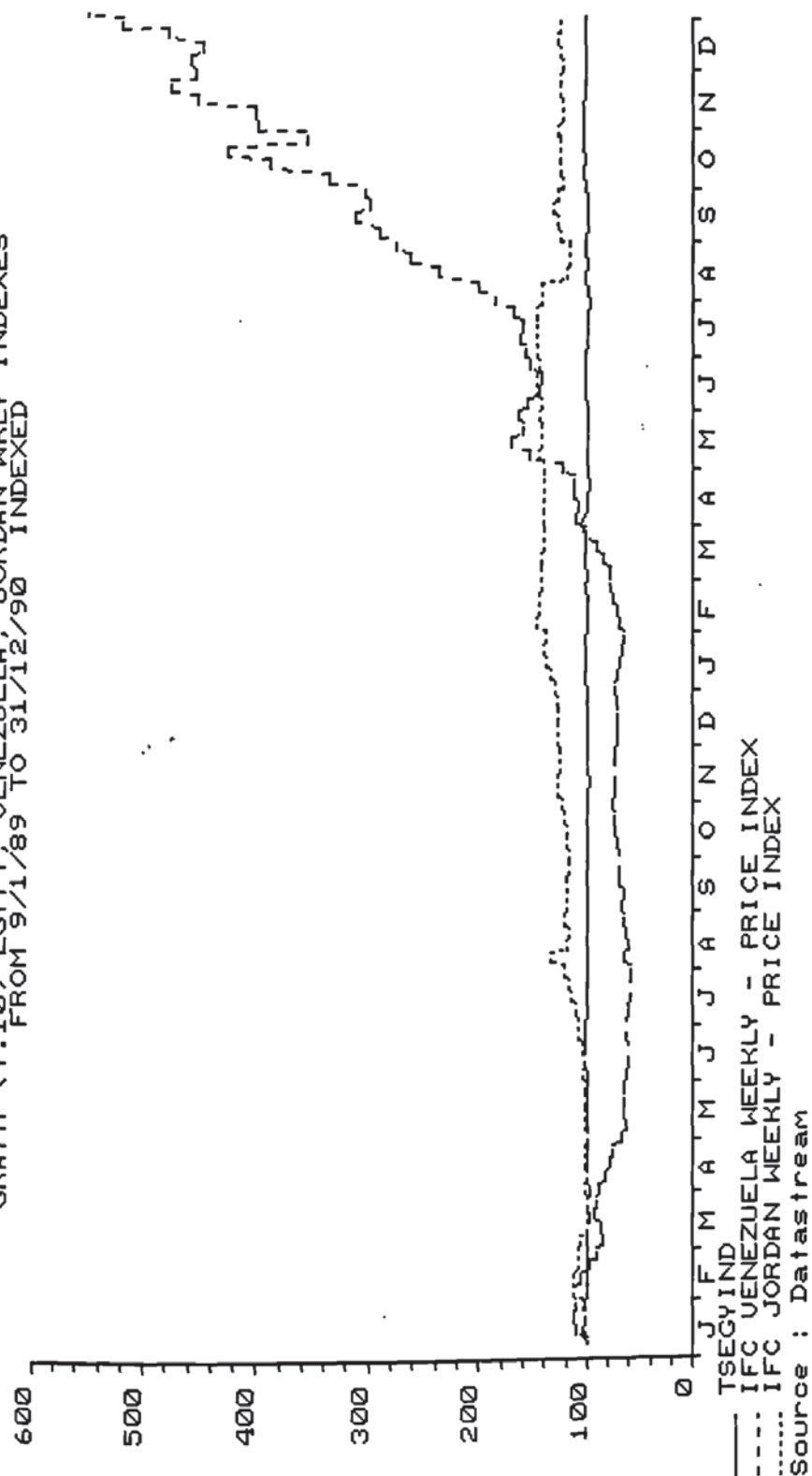
END OF DATA

```

GRAPH (7.9) EGYPT, GREECE AND JORDAN WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED

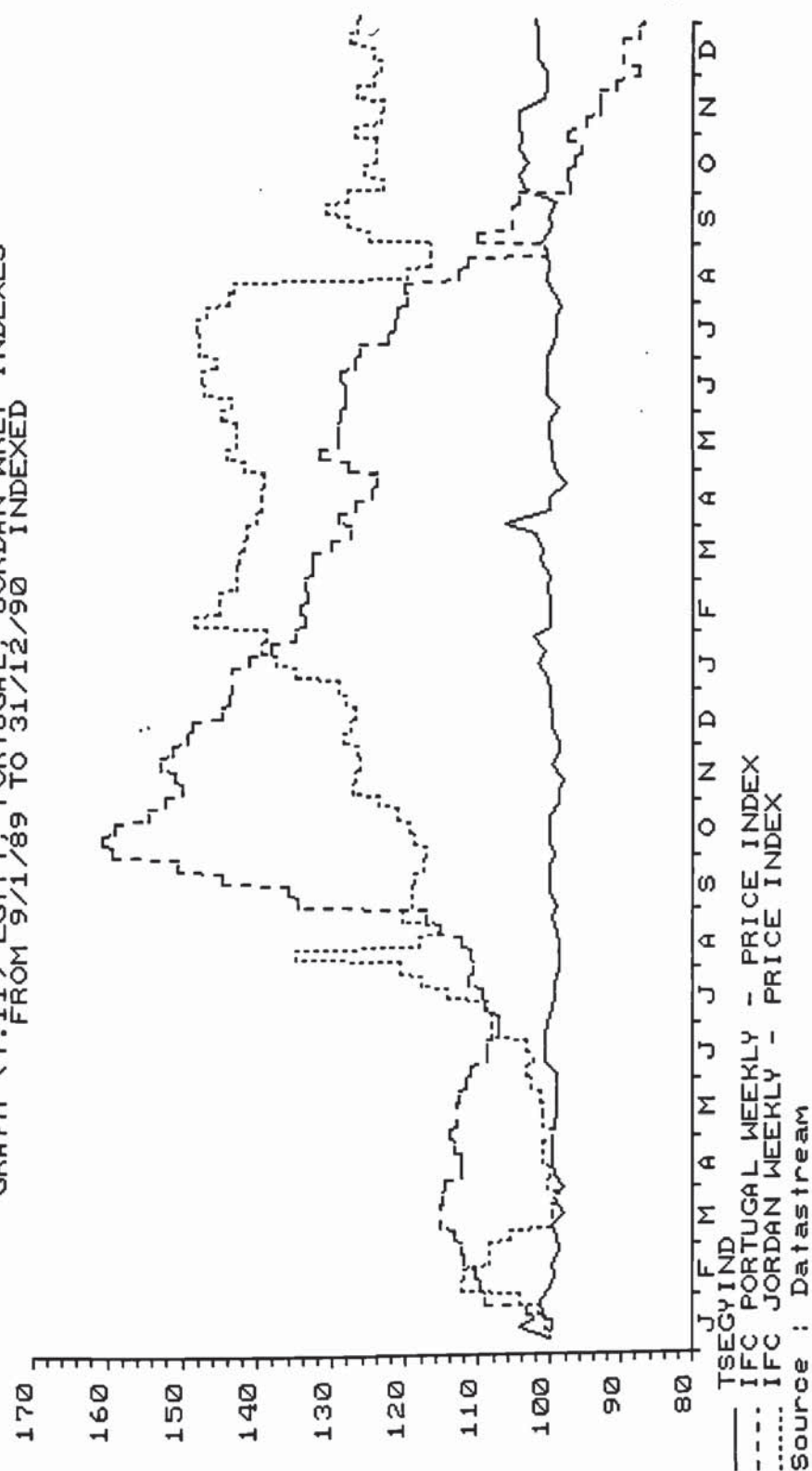


GRAPH (7.10) EGYPT, VENEZUELA, JORDAN WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED

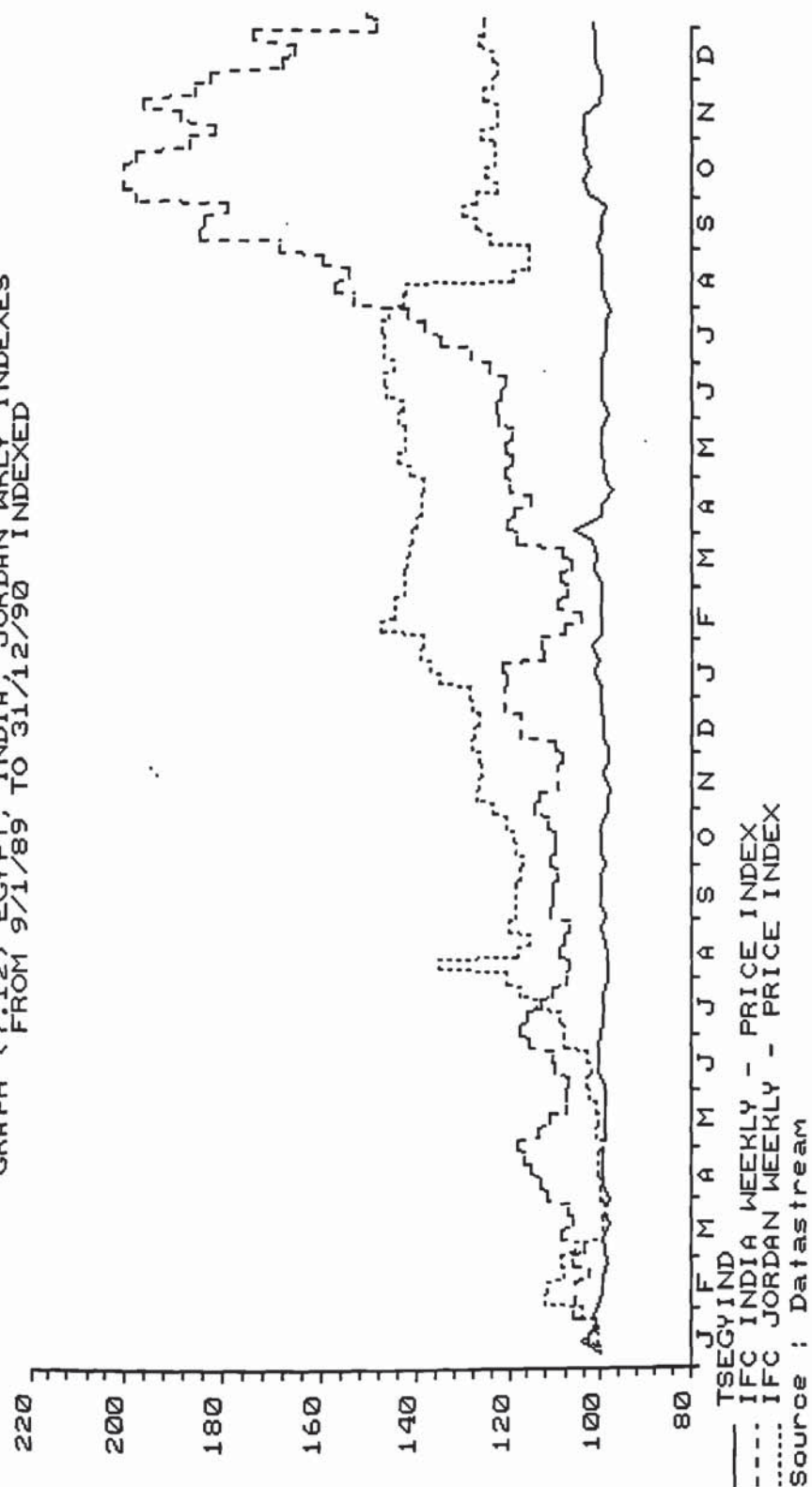




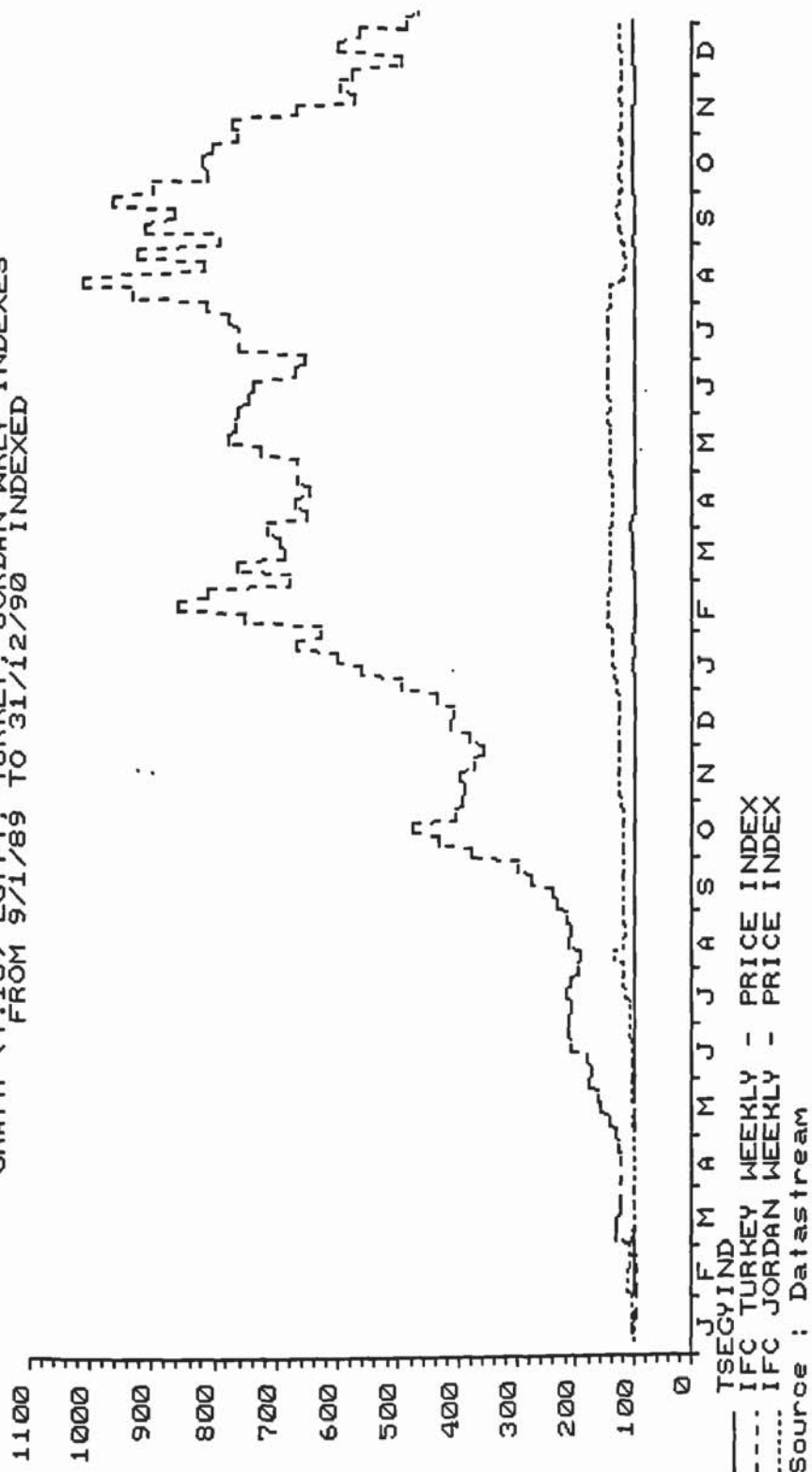
GRAPH (7.11) EGYPT, PORTUGAL, JORDAN WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED



GRAPH (7.12) EGYPT, INDIA, JORDAN WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED



GRAPH (7.13) EGYPT, TURKEY, JORDAN WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED



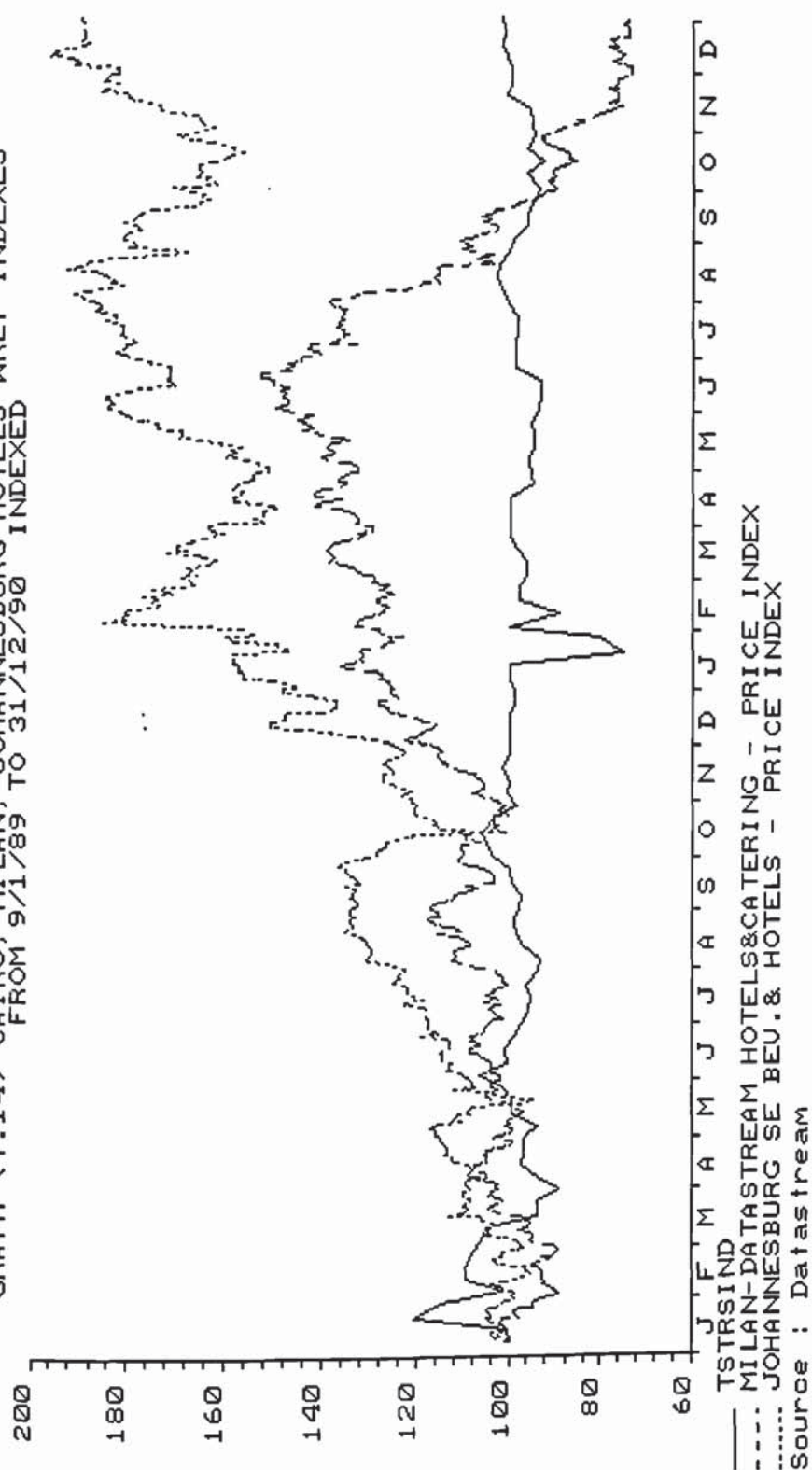
Source : Datastream



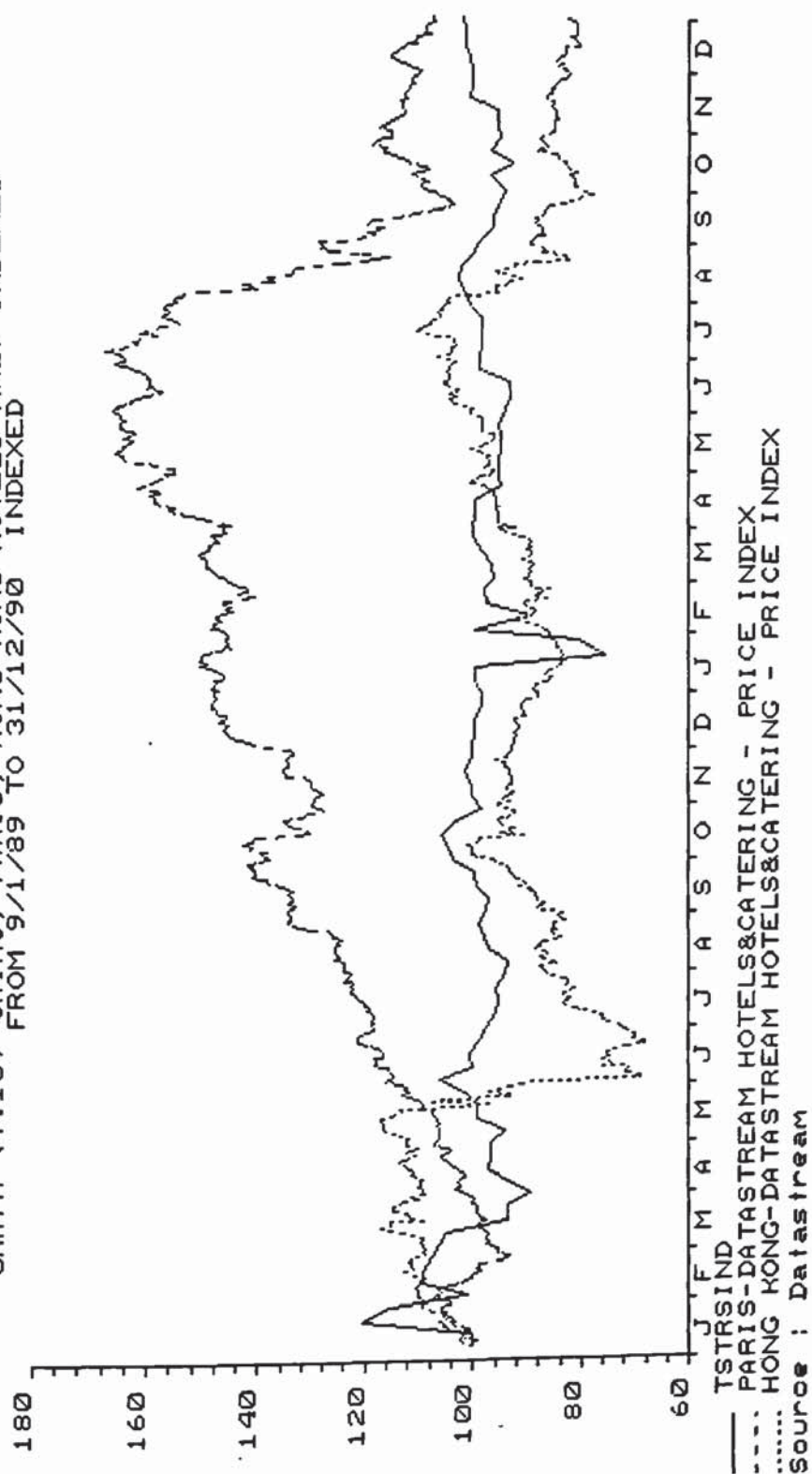
Table (7.6)

DATASTREAM 301S						21/ 9/92 16:55
BASE SERIES IS TSTRSIND						
FREQUENCY = W	REGRESSION TYPE = LINEAR					LAST VALUE = 102.02
FROM 9/ 1/89 TO 31/12/90						
TITLES:	LAST VALUE	REGRESN COEFF	STD ERROR	CORR COEFF	R SQUARED	
MILAN-DATASTREAM HOTELS&CATERING - PRICE INDEX	233.105	-0.0244	0.00822	0.26281	0.06907	
JOHANNESBURG SE BEV.& HOTELS - PRICE INDEX	6680.00	-0.0014	0.00048	0.25064	0.06282	
PARIS-DATASTREAM HOTELS&CATERING - PRICE INDEX	647.978	-0.0116	0.00412	0.24828	0.06164	
HONG KONG-DATASTREAM HOTELS&CATERING - PRICE INDEX	278.930	0.02707	0.01395	0.15957	0.02546	
AMSTERDAM-DATASTREAM HOTELS&CATERING - PRICE INDEX	145.668	-0.0498	0.02847	0.13784	0.01900	
ZURICH-DATASTREAM HOTELS& CATERING - PRICE INDEX	209.512	0.06779	0.04169	0.12339	0.01522	
LONDON-DATASTREAM HOTELS&CATERING - PRICE INDEX	3242.63	-0.0001	0.00139	0.09874	0.00975	
FTA HOTELS & LEISURE - PRICE INDEX	1208.61	0.00038	0.00284	0.09815	0.00963	

GRAPH (7.14) CAIRO, MILAN, JOHANNESBURG HOTELS WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED

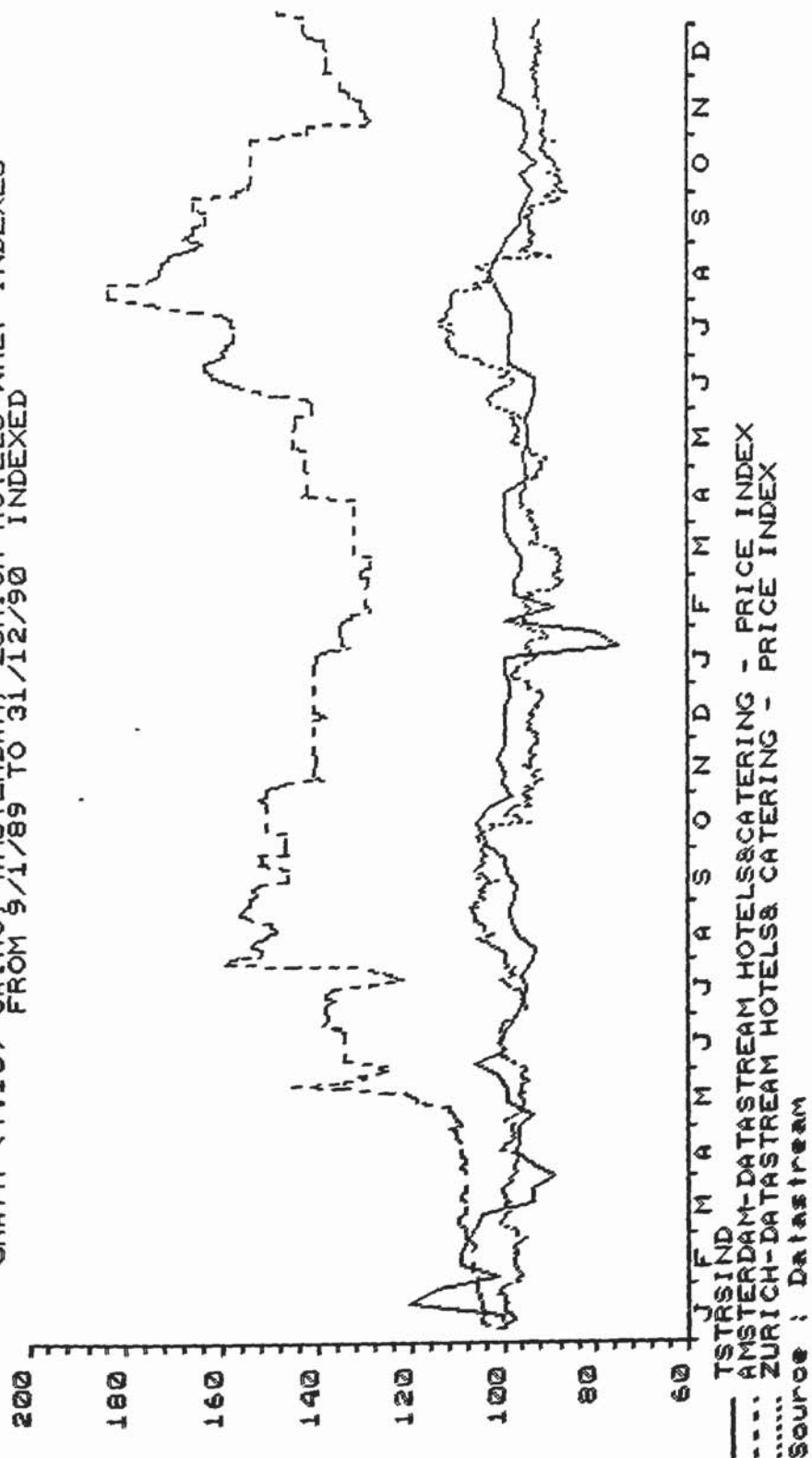


GRAPH (7.15) CAIRO, PARIS, HONG KONG HOTELS WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED





GRAPH (7.16) CAIRO, AMSTERDAM, ZURICH HOTELS WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED



GRAPH (7.17) CAIRO, LONDON DATASTREAM, FTA HOTELS WKLY INDEXES  
FROM 9/1/89 TO 31/12/90 INDEXED

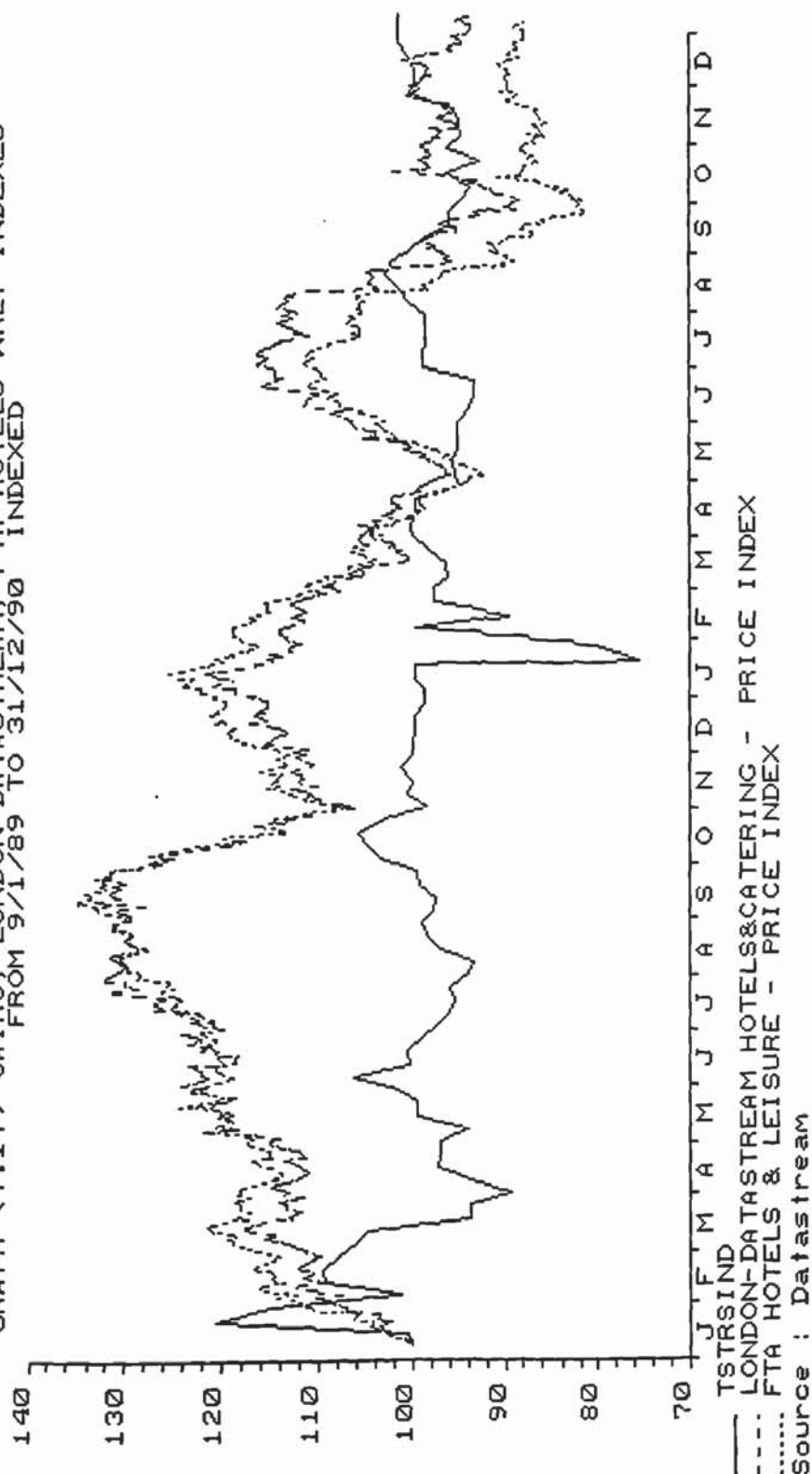


Table (7.7)  
EGYPT (1980-1989)

		1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
LISTED COMPANIES		62	64	112	154	258	317	387	430	483	510
CAPITALIZATION L.E.		173	180	544	920	1406	1838	2333	4021	4147	4666
Millions \$		246	216	654	1106	1691	1382	1716	1826	1760	1855
VALUE TRADED L.E.		11	10	10	26	110	126	243	357	256	210
Millions \$		16	13	12	32	132	97	180	167	115	84
TURNOVER RATIO		6.4	5.6	1.8	2.8	7.8	6.9	10.4	8.9	6.2	4.5

EGYPT (1981-1989)

PERCENTAGE CHANGE		1981	1982	1983	1984	1985	1986	1987	1988	1989	ANN AVG COM RTE
NO. OF LISTED CO'S		3.2%	75.0%	37.5%	67.5%	22.9%	22.1%	11.1%	12.3%	5.6%	28.6%
MKT CAPITALIZ L.E.		4.0%	202.2%	69.1%	52.8%	30.7%	26.9%	72.4%	3.1%	12.5%	52.7%
\$		-12.2%	202.8%	69.1%	52.9%	-18.3%	24.2%	6.4%	-3.6%	5.4%	36.3%
VALUE TRADED L.E.		-9.1%	0.0%	160.0%	323.1%	14.5%	92.9%	46.9%	-28.3%	-18.0%	64.7%
\$		-18.8%	-7.7%	166.7%	312.5%	-26.5%	85.6%	-7.2%	-31.1%	-27.0%	49.6%
TURNOVER RATIO		-12.6%	-66.9%	53.7%	176.8%	-12.4%	51.9%	-14.8%	-30.5%	-27.1%	13.1%

Egypt versus other capital markets (1989)

	Listed Companies	Capitalization Millions \$	Value Traded Millions \$
Egypt	510	1855	844
Jordan	106	2162	652
Greece	119	6376	549
Turkey	50	6738	798
U.K.	2015	826598	320268
U.S.A.	6727	3505686	2015544

Values are given in L.E. and \$ due to the variance in exchange rates

Source: For years 1980-88 is: Emerging Stock Markets Factbook 1990  
by IFC, while year 1989 is from Cairo Stock Exchange.



TABLE (7.8)

EMERGING MARKETS	NUMBER OF LISTED COMPANIES										
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	%
Argentina	278	263	248	238	236	227	217	206	186	178	1.6
Bangladesh	22	25	28	43	56	69	78	85	101	116	1.0
Brazil	426	477	493	505	522	541	592	590	589	592	5.3
Chile	265	242	212	214	208	228	231	209	205	213	1.9
Colombia	--	--	193	196	180	102	99	96	86	82	0.7
Costa Rica	13	19	24	32	41	51	61	71	76	78	0.7
Cote d'Ivoire	22	23	25	25	25	25	25	25	24	--	0.0
Egypt	62	64	112	154	258	317	387	430	483	510	4.6
Greece	116	111	113	113	114	114	114	116	119	119	1.1
India	2265	2114	3358	3118	3882	4344	4744	5560	5841	6000	54.1
Indonesia	6	8	14	19	24	24	24	24	24	61	0.5
Jamaica	38	36	35	36	36	38	40	43	44	45	0.4
Jordan	71	72	86	95	103	104	103	101	106	106	1.0
Kenya	54	55	54	54	54	54	53	53	55	57	0.5
Korea	352	343	334	328	336	342	355	389	502	626	5.6
Kuwait	--	--	--	--	--	55	70	64	65	52	0.5
Malaysia	182	187	194	204	217	222	223	232	238	251	2.3
Mexico	259	229	206	163	160	157	155	190	203	203	1.8
Morocco	78	75	78	76	77	76	76	76	71	71	0.6
Nigeria	90	93	93	93	93	96	99	100	102	111	1.0
Pakistan	314	311	326	327	347	362	361	379	404	440	4.0
Peru	103	133	144	150	157	159	177	197	236	265	2.4
Philippines	195	190	200	208	149	138	130	138	141	144	1.3
Portugal	25	23	26	25	23	24	63	143	171	182	1.6
Sri Lanka	--	--	--	--	--	171	171	168	176	--	0.0
Taiwan, China	102	107	113	119	123	127	130	141	163	181	1.6
Thailand	77	80	81	88	96	100	98	125	141	175	1.6
Trinidad & Tobago	--	29	34	34	36	36	33	33	33	31	0.3
Turkey	--	--	314	--	373	--	40	50	50	50	0.5
Uruguay	54	50	49	47	43	43	41	41	40	39	0.4
Venezuela	--	--	98	--	116	108	108	110	60	60	0.5
Zimbabwe	62	62	62	60	56	55	53	53	53	54	0.5
Total	5531	5421	7347	6764	8141	8509	9151	10238	10788	11092	100

"---" = Not available

Source: IFC 'Emerging Stock Markets Factbook 1990'

TABLE (7.9)

\$ million	MARKET					CAPITALIZATION					
EMERGING MARKETS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	%
Argentina	3864	2056	974	1386	1171	2037	1591	1519	2025	4225	0.7
Bangladesh	27	30	34	48	87	113	186	405	430	476	0.1
Brazil	9160	12598	10249	15102	28995	42768	42096	16900	32149	44368	7.2
Chile	9400	7050	4395	2599	2106	2012	4062	5341	6849	9587	1.6
Colombia	344	274	321	248	237	302	332	458	437	--	0.0
Costa Rica	1605	1399	1322	857	762	416	822	1255	1145	1136	0.2
Cote d'Ivoire	--	--	--	118	156	195	246	--	--	--	0.0
Egypt	246	216	654	1106	1691	1382	1716	1826	1760	1855	0.3
Greece	3016	2266	1923	964	766	765	1129	4464	4285	6376	1.0
India	7585	11802	11497	8510	8018	14364	13588	14480	23845	27316	4.5
Indonesia	63	74	144	101	85	117	81	68	253	2514	0.4
Jamaica	54	127	177	113	142	266	536	631	796	957	0.2
Jordan	1605	2457	2845	2713	2188	2454	2839	2643	2233	2162	0.4
Kenya	--	--	--	--	--	--	--	--	474	--	0.0
Korea	3829	4224	4408	4387	6223	7381	13924	32905	94238	140946	23.0
Kuwait	--	--	--	--	--	--	10108	14196	11836	9932	1.6
Malaysia	12395	15300	13903	22798	19401	16229	15065	18531	23318	39842	6.5
Mexico	12994	10100	1719	3004	2197	3815	5952	8371	13784	22550	3.7
Morocco	441	377	292	253	236	255	279	357	446	621	0.1
Nigeria	3118	3010	1458	2970	3191	2743	1112	974	960	1005	0.2
Pakistan	643	864	877	1126	1226	1370	1710	1960	2460	2457	0.4
Peru	--	1371	685	546	397	760	2322	831	--	--	0.0
Philippines	3478	1738	1981	1389	834	669	2008	2948	4280	11965	2.0
Portugal	191	156	92	84	73	192	1530	8857	7172	10618	1.7
Sri Lanka	--	--	--	--	--	365	421	608	471	--	0.0
Taiwan, China	6082	5312	5086	7599	9889	10432	15367	48634	120017	237012	38.7
Thailand	1206	1003	1260	1488	1720	1856	2878	5485	8811	25648	4.2
Trinidad & Tobago	--	1175	1357	1011	843	463	374	388	268	411	0.1
Turkey	477	511	952	968	956	--	935	3221	1135	6783	1.1
Uruguay	189	60	24	9	9	15	35	40	24	--	0.0
Venezuela	2657	2441	2415	2792	--	1128	1510	2278	1816	1156	0.2
Zimbabwe	1456	--	355	265	176	360	410	718	774	1067	0.2
Total	86125	87991	71399	84554	93775	115224	145164	201292	368491	612985	100

"--" = Not available

Source: IFC Emerging Stock Markets Factbook 1990

TABLE (7.10)

\$ million	VALUE					TRADED					
EMERGING MARKETS	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	%
Argentina	1089	454	231	389	277	631	309	251	593	1916	0.2
Bangladesh	--	--	--	--	0.4	1	2	6	4	5	0.0
Brazil	5313	6230	5961	4887	9962	21484	28912	9608	17979	16762	1.4
Chile	548	375	163	65	51	57	298	503	610	866	0.1
Colombia	187	332	93	65	47	30	49	80	63	74	0.0
Costa Rica	--	--	--	--	0.2	0.3	0.4	1	1	4	0.0
Cote d'Ivoire	6	7	48	2	1	1	3	14	9	--	0.0
Egypt	16	13	12	32	132	97	180	167	115	84	0.0
Greece	86	55	37	17	12	17	32	441	313	549	0.0
India	2760	7386	5030	2377	3916	4959	10781	6743	12241	17362	1.5
Indonesia	9	12	19	11	2	3	1	3	4	541	0.0
Jamaica	3	2	6	5	7	21	68	73	25	90	0.0
Jordan	139	227	318	329	138	163	185	420	337	652	0.1
Kenya	--	--	--	--	--	--	--	--	--	--	0.0
Korea	1867	3721	2700	2260	3869	4162	10889	24919	79180	121264	10.5
Kuwait	--	--	--	--	--	387	1412	3023	2543	1709	0.1
Malaysia	2572	3498	1392	3398	2226	2335	1180	3829	2623	6888	0.6
Mexico	3262	4181	781	1112	2160	2360	3841	15554	5732	6232	0.5
Morocco	--	--	10	17	16	13	9	8	33	--	0.0
Nigeria	14	10	12	18	16	15	16	7	5	4	0.0
Pakistan	--	--	--	--	180	236	155	162	177	193	0.0
Peru	134	79	41	26	28	38	239	301	57	90	0.0
Philippines	619	163	142	483	125	111	563	1524	875	2410	0.2
Portugal	2	2	1	1	3	5	60	1518	1136	1912	0.2
Sri Lanka	--	--	--	--	--	3	5	11	12	--	0.0
Taiwan, China	4503	5677	3422	9081	8194	4899	18931	84112	275624	965840	83.3
Thailand	308	108	238	381	434	568	1133	4633	5598	13452	1.2
Trinidad & Tobago	--	19	232	151	76	61	52	25	22	69	0.0
Turkey	--	--	--	10	7	--	13	115	101	798	0.1
Uruguay	21	11	3	1	0.4	0.4	2	4		1	0.0
Venezuela	60	47	82	59	27	31	52	148	221	93	0.0
Zimbabwe	154	136	75	38	6	9	12	23	39	36	0.0
Total	23672	32745	21049	25215	31913	42697	79384	158226	406272	1E+06	100

"--" = Not available

Source: IFC 'Emerging Stock Markets Factbook 1990'



Table (7.11)

Egypt turnover's ratio in relation to other markets

Emerging Markets	Value Traded	Market Capitalization	Turnover Ratio	Ranking
Argentina	1916	4225	45.3	5
Bangladesh	5	476	1.1	23
Brazil	16762	44368	37.8	6
Chile	866	9587	9.0	17
Cote d'Ivoire	74	-	-	-
Colombia	4	1136	0.4	25
Costa Rica	-	-	-	-
Egypt	84	1855	4.5	21
Greece	549	6367	8.6	18
India	17362	27316	63.6	3
Indonesia	541	2514	21.5	9
Jamaica	90	957	9.4	16
Jordan	652	2162	30.2	7
Kenya	-	-	-	-
Korea	121264	140946	86.0	2
Kuwait	1709	9932	17.2	13
Malaysia	6888	39842	17.3	12
Mexico	6232	22550	27.6	8
Morocco	-	621	-	-
Nigeria	4	1005	0.4	24
Pakistan	193	2457	7.9	20
Peru	90	-	-	-
Philippines	2410	11965	20.1	10
Portugal	1912	10618	18.0	11
Sri Lanka	-	-	-	-
Taiwan, China	965840	237012	407.5	1
Thailand	13452	25648	52.4	4
Triandad	69	411	16.8	14
Turkey	798	6783	11.8	15
Uruguay	1	-	-	-
Venezuela	93	1156	8.0	19
Zimbabwe	36	1067	3.4	22

Value Traded and Market Capitalization retrieved from IFC 'Emerging Stock Markets Factbook 1990'. Figures in \$ millions.

Turnover ratio = Value Traded/Market capitalization

- means not available

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