

SMALL AND MICRO ENTERPRISES IN EGYPT: FEATURES AND FUTURE

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ABSTRACT

In the context of the Economic Reform and Structural Adjustment Program that the Government of Egypt (GOE) has undertaken, private sector development (PSD) and industrial liberalization play a major role. Key to the economic reform program, is the successful gradual shift to a dynamic, market-based economy in which an unprotected and competitive private sector assumes the lead. SMEs are currently the largest employer of the Egyptian labor force, and contribute the most significant portion of the economy's value added; nevertheless, the sector still retains cumbersome restrictions. Furthermore, with relatively few exceptions, SMEs do not have access to formal financial institutions, physical space and/or regional markets.

Keywords: SME, Private Sector, Industrial Development.

I. CHARACTERISTICS AND STATUS OF SMEs

Small enterprises have been defined as those with 6-15 employees, while micro-enterprises and rural development projects are defined as those with 1-5 employees (Stearns K., 1992). This class of enterprises share the following characteristics:

- 1) Average asset level below L.E 5,000
- 2) Savings are the most common resource of start-up funding
- 3) Labor intensive, and
- 4) Heavily concentrated in urban centers

The majority of SMEs are informal, in that they are not licensed to legally operate a business. Nearly all of SME operators are dependent on direct sales to their clients. Additionally, they are primarily directed to serve the low-income consumers, where low quality, low price products have a substantial market. Table (1) summarizes the major characteristics attributable to SME sectors throughout the world, which are generally applicable to describe the status of SMEs in Egypt.

Confusion and misunderstanding (see the widely varying statistics for the number of people employed by SMEs in Egypt below) as to the correct

definition of SMEs, has resulted in a relative shortage of data and statistics concerning that sector; however, there is growing interest in Egypt, and numerous attempts have been made to measure the sector's importance to the economy. However, official figures often fall short of reality; official counts do not include children (being employed) under the age of 16, itinerant workers and low-income households. CAPMAS also under-counts the employed labor force holding second jobs in the SME sector. The following are some informal sector enterprise counts based on official statistics:

- a) the lowest estimate -- 876,000 (Abdel-Fadil, 1983)
- b) 1,104,300 (CAPMAS, 1984, referring only to working children between the ages of 6-12)
- c) 3,000,000 (Rizq, 1988)
- d) 2,280,621 (Charmes 1991)

Today, Egypt has a population of nearly 60 million people and a labor force of 15.9 million (the "labor force" being the segment of the population, employed and unemployed, ages 16-60); of that 16 million people, SMEs employ nearly two thirds of the labor force, or around 11 million people (10.73 million -- USAID-Cairo, 1994). Furthermore, estimates suggest a work-force of 18 to 20 million

people, already employed within the informal/SME sector, or looking to enter into some type of economic activity in order to supplement their incomes; this is in both urban and rural areas.

It is this job population of 11 to 18 million people that presents a challenge to the GOE and the private

sector; the challenge being to find ways, within the context of the Egyptian economic environment, to substantially expand the available support to this population. Table 1 below exhibits the characteristics of the informal SME worldwide.

Table 1. Summary Characteristics of Informal SME Sectors Worldwide.

Traits of The Entrepreneur and Enterprise	Categories of Entrepreneurs	
	Micro-scale & Rural Development	Small-scale
Purpose of Enterprise	Survival	Growth
Employment Level	1-4	5+
Percent of Total SMEs	80%	20%
Educational Levels	Very low/low	Moderate
Main Sub-sector	Mkts./Serv./Comm Repair	Prod./Comm.
Income Levels	low/subsistence	Mod./high
Plant/Store Capacity	Non-existent/Low	Low/Mod.
Info./Technology	Non-existent/Low	Low/Mod.
Marketing Strategy	Walk-by/direct	Market Plan
Location	Mkt./Itin./Home	Home/Plant

* Key : Serv. = Service sub-sector; Prod. = Productive sub-sector; Comm. = Commercial
Mod. = Moderate ; Mkt. = Market Place (c.g., Khan Khalil); Itin. = Itinerant.

II. SMEs ROLE IN THE EGYPTIAN ECONOMY

The SME sector currently employs approximately 66 percent of Egypt's labor force. It is anticipated that 75 percent of the labor force will be employed within SMEs over the remainder of this decade. Examination of the role of SMEs will look at their impact on jobs, value added, and gross domestic product.

Jobs:

Over the past decade, the private sector has

managed to absorb one out of every two entrants into the labor force. Approximately 60 percent of these new jobs were created by non-agricultural SMEs (Weidemann, 1992). Within the private sector, nearly 90 percent of the registered establishments fall into the SME category.

Value Added

The combined private sector in Egypt provided nearly two thirds of the country's value added (61 percent) in FY 1992, and 53 percent when agricultural outputs are excluded. The largest

percentage of value added is produced by SMEs. The sector registers an impressive 80% of the total private value added (75% when agricultural outputs are excluded).

Gross Domestic Product

At present the public sector is the greatest contributor to the gross domestic product (GDP), generating nearly 60 percent of the total GDP of Egypt. Private sector investment, and foreign direct investment, generate an additional 30 percent of the GDP. This leaves the SME contribution with around 10 percent.

Role in Rural Economy

A recent review of the role of non-agricultural activities in the rural economy concludes that SMEs constitute a significant portion of that sector. They absorb a large quantity of rural labor and provide a major source of income to a majority of households; this is because they are the source of a particularly large share of sustenance to the low-income rural population; they also have a substantial impact on reducing income inequality. Non-farm activities are not only efficient contributors to the GDP, but they also stimulate agricultural growth through their effects on income, farm productivity and marketing costs.

Also SMEs play a critical role in times of economic change by providing a buffer for both upward and downward mobility. In short, SMEs can play a very favorable role in the Egyptian economy, and they should be given the necessary help to become a prominent sector.

III. KEY FACTORS FOR ESTABLISHMENT OF SMEs IN EGYPT

The needs of SMEs differ according to their category. For micro-scale and rural development, the main barrier to entry is access to finance. For small-scale enterprises the list of barriers includes, access to finance, access to physical space, and access to markets.

Access to Finance

This category includes start-up costs, working capital and investment capital for land/work facilities and equipment. The amount of finance required by the different sectors of SMEs depend on the following: location of the workplace itself; the level of investment in equipment and the level of inventories.

The banking system in Egypt offers limited financing instruments to private enterprises. The longest repayment schedule offered by banks on loans to the private sector is five years (the average loan matures in two and a half years); SMEs generally receive more limited credit. Credit is rarely given to certain sectors (e.g., mortgage markets), and consumer credit is still in the early stages of development. Local bankers attribute the reluctance to extend long-term credit to the following:

- 1) The lack of long-term project assessment capabilities,
- 2) The general macroeconomics uncertainty, and
- 3) The high cost of collateral recovery (caused by the poor state of the commercial judicial system).

As a result, Egypt's banks concentrate on short-term commercial lending to medium and large companies.

Access to Physical Space

Location factors play an extremely important role in determining the concentration of SME sub-sector activities and their potential for economic and financial viability. Key determinants include:

- 1) Urban-rural linkages (commodity flows and market-place fluctuations)
- 2) Local population concentrations
- 3) Transportation infrastructure (railroad, bus and road access and services)
- 4) Market infrastructure, such as warehousing facilities.

For SMEs to operate effectively, they have to be located within/ near populated areas, where they

may obtain better access to labor; be closer to the markets they serve; and reduce the need to, and costs of transport.

Access to Markets

The demand for goods and services produced by SMEs throughout the world is derived from four sources:

- a) The domestic demand for consumer goods and services stemming from the incomes of (primarily low-income) rural and urban households,
- b) The backward and forward production and distribution linkages between SMEs and other producing units of the domestic economy (a strong source of demand for SME goods and services, in many countries, flows from their linkages to other sectors of the economy as well as linkages through transactions with a given sub-sector),
- c) The government and public sector, and
- d) Export markets.

Clearly, the primary demand for SME goods and services in Egypt lies within the domestic market, and particularly among low-income households (Liedholm, Mead, 1987). Strong inter-sectoral linkages are demonstrated in the forward linkages from agriculture to SME production and service activities, which are reflected in food processing, transport, machinery maintenance and marketing services (e.g., packaging, point of sale), and backward linkages, from large and medium-scale enterprises and government to SMEs. The high value added could be seen as evidence that there is a strong market demand and there are reasonable profits returning to the owners/operators. Specific studies regarding the sufficiency of market demand for SMEs to remain in business; let alone expand, are unknown.

IV. KEY FACTORS FOR SUSTAINING SMEs IN EGYPT

A number of factors are essential for the sustainability of the small-scale enterprises in Egypt. These have been identified as sustainable access to

finance, access to technology, management and market potentials and human resource development and management.

Sustainable Access to Finance

All SMEs need access to periodic financing, on a sustainable basis. For example, in Korea, the Industrial Bank of Korea is responsible for short and medium term loans to SMEs.

Access to Technology

"Evolutionary" changes in products and/or services and technology/design will continue to be a major threat to the survival of the small-scale enterprises. Unless SMEs have access to technology and research and development, their lifetimes will be very short. This directs us to the problem of SME integration.

Management and Market Potential

This depends on the capacity of the operator, and includes organizational capacity, access to information, management capacity, and market survey, and are referred to as internal factors.

Manpower

Labor productivity is the key to any enterprise remaining competitive and/or expanding in a market-based economy. Here also, government and the private (business community) policies can produce profound increases in productivity as well as upward mobility in labor income by educating and training the labor force. Conversely, the lack of investment in human capital can severely constrain productivity and competitiveness in an open market, and contribute to stagnant economic growth nation-wide.

V. CONSTRAINTS FOR SMEs DEVELOPMENT IN EGYPT

Access to finance of fixed assets for expansion

Further development of SMEs will, at certain stages, only be possible through expansion of fixed

assets acquisition (Fixed capital for new machinery and equipment in order to produce better quality or more diverse products). This, in turn, requires access to long term financing of fixed assets.

Space for expansion

This continues to be a major problem facing entrepreneurs planning further expansion of their businesses. A number of governates deny granting licenses to new projects within metropolitan/ urban areas citing, among other things, environment protection concerns.

Market Penetration

The most important development for this group of producers involved a shift to a more active approach to marketing, by breaking the constraints that tie their sales to final consumers. Producers need to receive better information about, and establish channels for selling in more dynamic markets. They also need to develop and modify their output in ways that link a constantly changing set of products that people want to buy. This leads us to the importance of technical assistance and research and development.

Tax Administration

Tax rates, including the corporate taxes and income tax on dividends for industry and businesses, are high, while tax administration remains complex and frequently arbitrary. This burden discourages business expansion and induces widespread tax evasion among SMEs, and the private sector as a whole. The tax administration is charged with auditing all tax returns. Additionally, there is a five-year period in which tax authorities can place claims against the tax return or entrepreneur. This policy leads to the frequent use of "claims" before the five years elapse, in order to trigger a second five-year period of tax inspection.

In addition to the above mentioned constraints, the GOE needs more efficient application and enforcement of the laws and regulations already on the books. The current situation is detrimental to the establishment of a healthy business climate for

development and growth of SMEs.

Some Barriers to Success for Rural Development

As noted earlier, small and medium enterprises do not share the same barriers to entry, sustainability and development. This is as opposed to the situation of micro-scale and rural development, where the main barriers to entry and sustainability, lie in access to financing, and the scope for development is deficient.

Table 2 summarizes the study by Weidemann and Merabet of entrepreneurs' needs in three areas; 1) at the point of start-up, 2) current problems and, 3) requirements for expansion. It is worth mentioning that the role of women in rural SME ownership and employment is more substantial than in urban enterprises. For about half of the women in those areas, it provides a supplementary source of income to agricultural activities. Women also predominate in the food, garment and crafts industries. In support of this argument, table 2 indicates financing as the primary need; availability of space for SMEs ready to expand, and raw material costs, also pose a problem. It is interesting to note that training and/or technical assistance does not appear as a significant need for the respondents.

VI. SUCCESSFUL EXPERIENCE IN SMEs ESTABLISHMENT, SUSTAINABILITY AND GROWTH

a) The Bangladesh Experience in Rural Development

The Bangladesh experience with SMEs represents a very successful case in the area of rural development. This achievement has been facilitated by the establishment of Grameen Bank. Grameen bank began as an "action research project" under the patronage of Bangladesh Kirshi Bank. Through this bank more than a million formerly very poor rural households in Bangladesh have improved their living standards significantly. The bank's approach towards achieving this involves disbursement of small loans, exclusively to the rural households in the lowest income categories, to finance additional income-generating activities at reasonable terms,

requiring neither collateral nor guarantors.

b) Korean Experience with Medium and Small-scale Enterprise

The last 30 years have witnessed a change in the attitudes towards SMEs in Korea, due to the realization of its major role in adding vitality to the economy. In response, the Korean government has taken very rigorous steps towards the promotion of SMEs, among which are:

- a) Establishment of NGOs solely for SMEs. Korean Federation of Small Business, The SME Institute, and SME Promotion Organization facilitated the development of comprehensive promotional policies and systematic financial assistance for SMEs.
- b) Establishment of the Industrial Bank of Korea specialized in giving financial assistance to SMEs.
- c) Establishment of the Korean Credit Guarantee Federation, to extend guarantees for the liabilities of promising business enterprises which lack tangible collateral to obtain funds from financial institutions.
- d) Promoting cooperative activities among SMEs. Such activities could possibly bring about economies of scale by encouraging them to work together in certain aspects of business and to share management information together. For that purpose the government enacted the Small Business Cooperative Act in December 1961.
- e) Promoting SME exports. In accordance with this plan, 350 SMEs have been designated as potential exporters and have been provided with various incentives designed to strengthen their international competitiveness. In selecting the eligible firms, priority was given to those demonstrating prospects for increased export volume, strong foreign exchange earnings, and efficient use of existing facilities.
- f) Establishment of industrial estates to provide accommodations for, and to ensure economies of scale for export SMEs.

VIII. RECOMMENDATIONS

- 1) Promote the NGO/Bank SME lending models

which utilize professional bank lending operations and the appropriate, successful features of NGO and community banking models from around the world; and share the operational systems with a broader cross-section of banks.

- 2) Offer incentives and more relaxed terms for banks willing to specialize in funding SMEs. These banks should play the significant role of promoting independent economic activities of small and micro enterprises and enhancing their economic position in the national economy. In pursuit of that purpose, they should conduct the following activities:
 - a) Provide payment acceptances and guarantees
 - b) Act as a treasury agent
 - c) Borrow funds from other financial institutions
 - d) Borrow foreign capital for SMEs
- 3) Establish a Small and Micro Enterprises Promotion Fund to secure the financial sources needed for the promotion of SMEs. The fund should be financed by contributions from the government, and business associations, loans, profits yielded by operation of the fund and grants from the donor countries. The fund should be managed by a board of directors representing the business community and experts. The fund should be used to carry out the following activities:
 - a) Modernization projects,
 - b) Facilitating business conversion projects,
 - c) Cooperation projects,
 - d) Career/employment guidance and training projects,
 - e) Fostering rural small industry and the indigenous craft industry,
 - f) Investment in business to support vulnerable enterprises and commercialize new technology,
 - g) Development and introduction of technology by small entrepreneurs,
 - h) Start-up assistance for SMEs,
 - i) Leasing facilities for the projects,
 - j) Collecting, disseminating, investigating and researching information,
 - k) Provide subsidies (if necessary) to enhance/encourage the success of the

above activities.

Generally, the fund should be established to secure financial resources necessary for technology development, management stability and business conversion

- 4) To extend the activities of the Principal Bank for Development and Agricultural Credit to those in rural areas who are not covered by the traditional banking system, in a similar way to the activities of the Grameen Bank. The Grameen Bank philosophy's direct manner, concerning development, should be adopted as a core to all development thinking and action. The most striking characteristic of Grameen Bank's social development program is its enlightened concern with a long term perspective. Removal or reduction of poverty is considered a continuous process of creation of assets, so that the asset-base of the poor becomes stronger with each economic cycle, therefore, enabling them to further increase their earnings. Moreover, every person must be allowed a fair chance to improve his/her economic condition; this can be done by ensuring the right to credit. Self-employment supported by credit carries more potential for improving the asset-base than wage employment. Creating favorable conditions for making a living through self-employment is a much more efficient and dignified way of solving the unemployment problem than instituting a system of doles and welfare payment. We suggest the bank's board of directors to be composed of government and the private sector representatives as a model for public private partnership.
- 5) Establish a Small and Micro Enterprises Council
The government and the business associations should appropriate the expenses necessary for the management of the council and its working committees. The council would be composed of not more than twenty members from public and private businesses with knowledge of, and experience with SMEs. The members should be ad hoc, and the council chaired by the Minister of Public Enterprise. The council should be authorized to formulate policies to,
 - a) Facilitate the development of SMEs and to enable founders to promote and develop their enterprises.
 - b) Survey and guide business management, train business managers and establish a business management guidance center.
 - c) Establish and expand research institutes, introduction and guidance for technology implementation training, etc.
 - d) Formulate standards and to inspect goods to improve the quality of goods and services provided by the SMEs.
 - e) Improve the working conditions of the SMEs
 - f) Install state of the art facilities, to supplement capital and equipment, and to rationalize facility arrangement.
 - g) Promote rural small and indigenous craft industries.
 - h) Promote subcontracting between the large, medium and the SMEs, and to rationalize subcontract conditions.
 - i) Establish a mutual aid system for SMEs so that they can avoid bankruptcy through mutual aid.
 - j) Establish orderly export transactions and open markets abroad.
 - k) Improve the system for tendering bids, in order to offer more opportunities for SMEs.
- 6) It is recommended that the Governorates and donors, utilizing qualified Business Associations, support the establishment of industrial estates/parks close to the metropolitan areas, as was done in Korea. As a pilot project, the GOE might allocate lands for industrial use to be developed and administered by Business Associations for SME industrial parks. Special funds should be made available by the donors to provide necessary infrastructures, shell-factory buildings, and estate management facilities for these properties.
- 7) Governorates should reconsider granting licenses to SMEs locating in urban areas,

which do not pose threats to the environment.

- 8) Business Associations are encouraged to play a role in providing SME entrepreneurs with, among other things,
 - a) Information on local and international markets and their prospects;
 - b) Market access by providing exhibition outlets.
 - c) Technical assistance and training on industry basis
 - d) Developing contacts between SMEs and middle and large scale industry/business.
 - e) Acquiring necessary skills and know-how of preparing, and entering, into a contracts and/or sub-contracts, through contract management training.
- 9) The Government, Governorates and Business Associations should act together to:
 - a) Encourage SMEs to cooperate in aspects of marketing, supply of raw material, research and development, and additionally, other possible aspects of production or service, to benefit from economies of scale and so have a more competitive position in export market.
 - b) Facilitate the establishment of links between SMEs and large-scale advanced industries, in a way that the latter take responsibility for some of the marketing and product development activities.
 - c) Encourage SMEs towards export markets by offering incentives to potential enterprises, both financially and non-financially.
 - d) Encourage private export enterprises for establishing exhibition outlets abroad by offering them funding and incentives.
 - e) Encourage labor intensive industries to be established near urban and metropolitan areas, offering them the same privileges as received in the new industrial cities.
- 10) Set an agreed upon model of industrial establishments that will satisfy all the necessary conditions, and free them from

licensing and other bureaucratic procedures.

- 11) Business Associations and NGOs should provide workshops, to be attended by SME clients, and led by local authorities to explain the establishment and operation licensing, social insurance application and the institution of laws. This would further the understanding of the laws and increase compliance.
- 12) Establish "Small Business Development Centers" in rural areas to stimulate and provide support for new and existing businesses. These centers are to be managed by Governorates representatives, Business Associations and NGOs. They can assist in a variety of ways, for instance,
 - a) By providing information and ideas for SME projects.
 - b) By providing land, premises and leasehold arrangements.
 - c) By providing the services of professional business advisors in technical, financial, legal, marketing and managerial matters.
 - d) By offering joint buying and selling services, thereby allowing each to gain the benefits of the economy of scale trading.
 - e) By providing management and man-power training facilities.
- 13) A fiscally neutral approach needs to be formulated and applied that widens the SME tax base, while allowing lower marginal tax rates.
- 14) On the global level, exert efforts and pressure the international institutions and developed nations to establish an "international bank for micro-enterprise development"; a proposal that was discussed several years ago, to provide finance on a large scale, to small lenders in the developing countries.

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