Internationalization in Egypt: Risks and Opportunities

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Despite of Egypt is facing a period of political uncertainty, some Italian firms have a great interest in operating business in Egypt. Egypt has bilateral agreements with Italy since 2007. As a result of this relation, Italy has become a strategic partner for Egypt, gaining a growing importance in the Middle East. Egypt is, also, an important trading partner for the Italy. Political and economic relationship between Egypt and Italy has increased the interest in analyzing risks and opportunities for Italian firms that would like to operate in Egypt. However studies focused on this topic are still missing. With the aim to fill this gap, this article presents a study based on face to face interviews to some Egyptian senior-executives who manage in Egypt productive centres and representative offices of Italian firms. These interviews led to evidence opportunities and risks that Italian firms have to face operating business in Egypt.

Keywords: internationalization, Italy, Egypt, cross-national analysis

Italy Versus Egypt

Selection of market in which to operate is the core element of any international strategy (Goodnow & Hansz, 1972; Kobrin, 1976; Paliwoda, 1993; Root, 1994; Sarkar & Cavusgil, 1996; Simpson & Kuja, 1974; Wind, Douglas, & Perlmutter, 1973; Wind & Perlmutter, 1977). Most models view market selection process as composed of many stages (Cavusgil, 1985; Kumar, Stam, & Joachimshaler, 1994; Johansson, 1997). However any internationalization strategy has to start from the analysis of main risks and opportunities to operate in a specific country. Most literature is focused on developed countries and very few studies analyzes developing countries. This article aims to fill the gap analyzing main risks and opportunities for Italian firms that operate in Egypt. Economic reforms of 2004 has triggered an expansive cycle that has gradually consolidated over the years. The aborted GDP growth was supported by the positive contribution of tourism, the effects of fiscal stimulus plans adopted by the government and the early signs of resumption of private sector investment. The reduction of customs duties and a simplification of import procedures have had significant positive effects on Egypt’s interchange with Italy. The data show that, within three years, the interchange between the two countries has more than doubled, growing considerably both in terms of the import and the export. Italy represents the second largest trading partner of the United States and Egypt after before Saudi Arabia, India, France, China, Spain, and Germany. Oil and dairy products make up more than 50% of the total value of

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exports to Italy, with a consistent increase during 2008, compared with 2010. Steel products, chemicals, manufactured goods, and agricultural products, are other important items of Egyptian exports headed for the Italy. Italy is the fifth country, after the United States, Saudi Arabia, China, and Germany. The main imported goods from Italy are machines for special applications, general purpose, basic chemicals, machinery for the production of mechanical energy, clothing and machinery for textile production. The 40% of the total imports of Egyptian companies from Italy consist of machinery and capital goods. Imports related to classical voices of Made in Italy, such as clothing, furniture, footwear, are rising trend although start at extremely low values, reflecting the limited purchasing power of middle Egyptian consumers. According to the data of the Bank of Italy, the average annual flow of Foreign Direct Investment (FDI) of Egypt to Italy has fluctuated from a low of 202 thousand euro in 2000 to a total of 29.6 million euros in 2005 to then fall in 2010 to 3.7 million euros. The average annual flow of FDI of Italy to Egypt between 2000 and 2010, was approximately 20 million. Subsequently, FDI is greatly diminished until the acquisition of Bank of Alexandria by IntesaSanpaolo in 2006 which did increase the flow to about 1.2 billion euros. The acquisition of 80% of the share capital of the Bank of Alexandria by Banca Intesa San Paolo in 2006, following the privatization of the Bank, which was the third most important Egyptian public bank, and the acquisition of Italcementi, through its subsidiary Suez Cement, some local production facilities as a result of the privatization process in the sector in 2005 were by far the most significant foreign investments in the country.

In Egypt, the Simest, the Ministry of industry, the Financial Action Task Force (FATF), and the Industrial Development Agency (IDA) are realizing the Parco della concia of Robbiki whose goal is to transfer and reallocate firms of Lean El Ouyoun in new Eco Park World Technology Robbiki, which was later to become the city of tanning and leather processing. The project involves the reallocation, in the industrial area of Robbiki, of 300 Egyptian companies. The new district Robbiki Leather Industrial Park, managed by the RLC development company—WTO, extends for approximately 2.2 km² to 54 km from Cairo. The new district offers businesses a complete package of services both in terms of infrastructure, utilities, as well as specific services for tanning of hides. Robbiki Leather City (RLC) is destined to become the industrial town of tanning and leather processing and an eco-technological park, able to offer businesses a complete package of services including the ability to ensure a sustainable eco-production, providing advanced techniques of technological innovation and specific assistance. Industrial districts and small and medium-sized Italian companies operating in the field of leather tanning and are therefore encouraged to participate in the project in order to receive discounts and benefits resulting from the birth of the new district. The project aims to contribute to the achievement of a new industrial district near the Cairo specializing in tanning of hides, introducing the use of innovative production systems and technologies compatible with respect for the environment. The district has skin as a precondition of the transfer of tanneries di Magra el Eion in new area of Robbiki, where they can be guaranteed a greater respect for the environmental quality and infrastructure more efficient. Precisely in this context should be seen collaboration between entrepreneurs for tanneries, trade associations and the Egyptian and Italian institutions, which allowed the exchange of skills and introduced a climate of mutual trust and willingness to participate along with this initiative. The Italian cooperation financed the infrastructural component for a total of 24 million euros in value on debt conversion fund, being aware of the potential for development of this sector for the Egyptian economy. In addition to the realization of the necessary
infrastructures, Italy contributes to the initiative through the creation of productive and commercial ties between the two countries and the transfer of technology and know-how. The technical assistance provided, from the outset, by the Association of Italian manufacturers of machinery and technologies for leather and skin (ASSOMAC), gave an important contribution to the start-up of the project and drove the process of transfer of know-how, in order to ensure its future sustainability. The successful model of the Italian industrial districts opened the way for cooperation agreements with the districts of Santa Croce, Arzignano, and Solfora. In addition, thanks to Bank of Alexandria, now, part of Intesa-San Paolo, the project can also benefit of a qualified Italian company finance. The Italian cooperation fails to take into account the social component of the project, mediating between the production requirements and the need for development and protection of locals. Here is the contribution of Italy in supporting Egypt to develop in all senses a new manufacturing plant, where the workers and their families can live in. Is an all-round activities which, together with the Egyptian government, aims to bring greater well-being in Badr city near the industrial complex of Robbiki, and the local population. In Egypt, according to data from the Embassy, there are several Italian companies of medium and large working in the service sector (Ama international, Iacorossi/Gesenu), impiantisicta (Ansaldo Spa, Danieli, Castagnetti, New pinion, Montubi, Gavazzi Technit CIMI, Impregilo Spa facilities), industry (Italcementi, Pirelli tires, EMB Electrical Industries SAE, Valvitalia, Vinavil Egypt, Miro Radici, Contonificio Albini Group, IVECO), petroleum (IEOCENIEnichem, Saipem, Edison International Spa) and transport (Grimaldi group, Ignazio Messina & co., Tarros S.p.a.). With the exception of large companies that are accredited in the Egyptian market for medium-sized companies is very difficult to enter the Egyptian market if not by local operators. Cultural closure adds inconsistencies and grey areas in the legal system and red tape which make it difficult to entry into the country is not conveyed by local operators.

Methodology

In order to investigate in more detail the characteristics of Italian companies operating in Egypt has been conducted an empirical survey on a sample of Italian companies operating in the area with headquarters in Egypt. Of these companies only 28% have capital entirely Italian while the remaining 72% have a mixed ownership structure made almost entirely from individuals of Egyptian nationality. These companies have, however, preferred to keep a leadership structure composed mostly by local managers who are able to drive the entire structure to avoid cultural frictions.

Main Risks and Opportunities to Operate in Egypt

Egypt is exposed to a variety of risks and is affected by a number of structural weaknesses that affect the entrance of foreign operators. Country risk rankings, updated by SACE in 2009, Egypt is placed in the fourth risk category on seven, considered as a medium risk. Despite the Egyptian authorities have adopted security measures on facilities and tourist spots after the attacks that occurred on October 7, 2004 and April 30, 2005, it maintains a watchful attitude in relation to the likelihood of terrorist threats. From the interviews conducted with a sample of Italian companies operating in Egypt has shown that political instability, the risk of nationalization and security are not considered to be significant deterrents to entry into the country. Major concern is the risk to inflation. The risks relating to the lack of transparency of rules and regulations is felt only
by half of respondents (50%) as of slight importance in the evaluation process of entry into the country, while the uncertainty in rules and local rules (56%) represents a major concern in the lobby firms in Egypt. The judiciary does not provide certainty about the time required for the accomplishment of varying degrees of judgement and the same legislation is sometimes contradictory hindering more than a little trade operations and investment. Theoretically allowed by local legislation is the recourse to international arbitration, which however is not always understood by local law. International arbitration is often preferred by Egyptian portion arbitration. Traders and investors complain of difficulty of amicable settlement of disputes, although lately some local organizations are putting in place the mechanisms to this aim, also in collaboration with the International Chamber of Commerce. Despite the lack of liquidity and the fixed exchange rate is because of the lengthening of payment periods and the consequent risk of insolvency, are not considered by the majority of companies surveyed major barriers to entry into the area. The country is characterized by certain limitations on freedom of expression, which sometimes result in various forms of censorship, and it is impossible for the Egyptian people to elect their own representatives. Investors who intend to operate in Egypt find difficulties in accessing information. The official source of statistical data is the Central Agency for Public Mobilization and Statistics (CAPMAS) and the General Authority for Investment and Free Zones (GAFI) provides information of the characteristics and opportunities that arise in the various sectors of the production system. However, establishing contacts with local stakeholders represents, in fact, the only form of access to relevant information. Inconsistencies and red tape are considered by the majority of companies surveyed (53%) to be a major obstacle to the companies entry into the country. The investment climate in Egypt is, indeed, red tape, lack of clear administrative procedures, lack of communication between different administrations concerned, inconsistent application of customs tariffs and procedures for the control of goods, inconsistent valuation of merchandise, non-tariff barriers to imports, including controls on samples of goods carried out sometimes in a non-conforming to international protocols, too slow and cumbersome to access judicial channels. The state apparatus and administrative-bureaucratic Egyptian is extremely complicated and complex. Overlapping rules, procedures of offices and expertise represent the everyday reality with which they must confront economic operators. Despite the current trend of the country to promote foreign direct investment in its territory, at the time of import of goods essential for the realization of an investment, it may happen that the customs authorities are not to apply simplified procedures, whether because of the disconnect between the various authorities, both in the amount of applicable rules inside which can be very difficult to find. To remedy these problems, the FATF has recently set up a one-stop-shop. One of the greatest difficulties faced by Italian companies of any size in Egypt is the lack of coordination among the authorities which promotes investment (GAFI) and customs authorities which formally depend on the ministry of finance, but are in fact autonomous. Bureaucratic inefficiency and corruption continue to create obstacles to the activities of foreign investors in the country.

Structural factors and modernization policies offer interesting opportunities for interested operators to enter Egypt. The Egypt offers an internal market of 70 million people and a growth rate strongly supported, and represents a key country for access to the Middle East and Africa, being one of the most important members of the Area of free trade between African countries (COMESA) and playing a political role in the Middle East
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linked to the progress of the peace process. According to most companies surveyed the area’s attractiveness is due to the possibility of exploiting local resources and to lower raw material costs and labor (67%), access to a cheap supply (67%), the extent of market outlets (89%) and local competitive structure (56%). Natural resources and landscape are at the root of the country’s economy and a source of attraction for many foreign operators. The country has huge deposits of oil and natural gas. Oil production meet Egyptian demand almost completely. The Egyptian natural gas use is extended to the whole country and is preparing to be exported in the near future when they completed the liquefaction plants and pipelines. The priceless cultural heritage which refers to different periods of its history and natural amenities make this country to be a privileged tourist destination. The creation of new hotels and resorts in Sharm-el-Sheikh, Hurghada, and Marsa Alam and the improvement of services and infrastructure have attracted 10 million tourists in 2008. Agriculture has always had a fundamental role in the economy of the country. Still, about one-third of Egyptian workforce is employed in that sector. Egyptian agriculture characterized until some time ago from a virtually absolute stillness to cotton monoculture, in recent years it is very diverse. Cotton crops were flanked by wheat, rice, corn, tomatoes, and sugar. The industry has become the driving force of economic growth. In recent years following the economic liberalization, industrial activity has diversified considerably in Egypt. The textile industry, for many years the basis of economic development, was reached by the agri-food and the chemistry, related to hydrocarbon processing and production of fertilizers for agriculture. In addition, the latent demand and expectations of improvement of the quality of life they presage a near-term development of the furniture industry and interior design, articles for lighting, house wares and small appliances, consumer electronics, toys, cosmetics and, more generally, personal care. Good infrastructure is the system of support to the development of local industry. In fact, there are all kinds of transport: rail, air, sea, river and through pipelines. Cairo is the nodal point of a modern railway network that extends for over 10,000 miles allowing the unification of Africa with the Mediterranean. The main stretch of rail transport between Aswan and areas to the North of the Valley of the Nile with Alexandria, on the Mediterranean coast. There are numerous bus routes linking Cairo with Alexandria, the area of Fayyum, the Sinai Peninsula and some centers of the Delta and Suez Canal zone. The country has over 3,500 miles of inland waterways. The main ports and harbors of the Mediterranean Sea are Alexandria, Egypt, Port Said, Damietta, Marsa Matrih, Red Sea Suez, Adabieh, Al Ghardaqah Sokhna, Hurghada, Safaga Safajah, Noucibah, Raithu, Sharm-al-Sheikh and the Nile are Assiut, Aswan. All major cities and tourist resorts are equipped with airport and there are daily flights to all destinations. The main airport is that of Cairo, linked to many airlines, and is the only one which can receive loads of goods. Transport aircraft are undergoing development and renewal processes, both in terms of the acquisition of new aircraft and magnification of the Cairo airport. Other airports are located in major cities and close to the tourist centers, such as Alexandria, Luxor, Aswan, Port Said, Hurghada, and Sharm el-Sheikh. The national airline is the Egypt Air, while other major airlines are Air Cairo, Heliopolis Air, Mid West, Air Sinai, Lotus, and Raslan. In addition to structural factors, the current flow of investments in Egypt depends on the reforms introduced by the government relating to business start-up, taxation, and to the stability of the currency, to measures to reduce bureaucracy, the establishment of a one-stop-shop is able to reduce time in setting up a business and the establishment of special economic zones, Franche, NUC and technology parks. Entrepreneurship development
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and trade liberalization have been the two pillars of the Egyptian economic modernization policy. The privatization process, launched in 1991 has undergone a rapid acceleration in recent years. By seven operations in 2002/2003, it reached a peak of 53 in 2005/2006, including the sale of 20% of the shares of Telecom Egypt and the privatization of Bank of Alexandria. In 2007, 16 transactions were made for an amount of approximately $260 million. Economic reforms adopted by 2004 by the Egyptian government have contributed to the growth of the economy, driven in particular by increased foreign investment and the increase in private consumption. These reforms have included the reduction of tariffs and rates, tax incentives, absence of limits on foreign participation, equality of treatment with national transferability of profits, recognition of international arbitrations.

Conclusions

The empirical analysis carried out on a sample of Italian firms internationalized in Egypt suggests that the determinants that push companies to invest in the country can be traced to the presence of factor endowments, to the poor competitiveness of local businesses and geographical proximity, plus the operations carried out by the government to encourage the gradual process of liberalization and privatization. The interviews show that Egypt also represents a substantial market outlets of our companies, intending to meet the emerging demand in the country and a significant market for the supply of major raw materials such as gas. The policy of encouraging the entry of foreign capital, formalized in a number of tax advantages and reductions, represented a further element of attractiveness for Italian companies. According to interviewees, linguistic and cultural differences do not have a significant weight in hindering the success of investments. However, to avoid possible crashes cultural, most companies operating in the area has preferred to identify local managers who are able to guide in a way that is not tax the entire organizational structure. Despite the gradual stabilization of the socio-economic framework, Egypt continues to show high levels of risk, especially with regard to the instability of the institutional environment, security issues, the lack of transparency of legislation and legal uncertainty. These obstacles, as with the other Mediterranean countries, seem destined to shrink as a result of the implementation of the Association Agreement, and in view of the creation of the free trade area, which are linked the funding earmarked for the development of the country. Regulatory uncertainty, red tape, difficulties related to the repatriation of capital and slightly lesser extent, the lack of infrastructure continue to represent major risks facing companies who choose to operate in the area.

References


