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Egypt Enterprise Sector Problems: The Case of Egypt Aluminum Co (2)

Dalia El-Agami

The Egyptian Public Enterprise Sector companies have been facing many problems that led to reducing the profitability of some companies, and turning others from profit-making companies into losing, faltering, and severely insolvent companies.

These problems are manifested in the rise in production costs due to the hiking prices of energy used in the production process, the severe neglect in maintaining machinery and equipment in factories and failure to renew them, the accumulation of productive stock and inability to market it, the poor management and confusion in decision-making, and the weak administrative control within companies.

These problems led to a decline in the productivity of companies, a decrease in their profitability, and an increase in their debts. Unfortunately, this coincided with the successive governments' tendency towards privatization since the emergence of economic openness in Egypt and the attempts to hold partnership between the private sector and the public sector in implementation of the International Monetary Fund (IMF) terms. Moreover, some companies were privatized, and others were liquidated, which had been seen as pioneers in their field.

The recent decision to liquidate the Iron and Steel Co was a fatal blow to the national industry, and a crime that has destroyed one of the pillars of heavy industries in Egypt, and posed threat the national security of the state.

Therefore, this paper sheds light on the situation of the Egyptian Iron and Steel Co, and explore whether the decision to liquidate the company was the only way out of the tunnel of successive losses incurred by the company in recent years, or that it was only a political decision far from stopping the bleeding of losses and achievement of the desired economic development?

Egypt's public enterprise sector companies:

The Public Enterprise Sector companies appeared in Egypt in the early nineties, where they are state-owned companies by no less than 51%. Public enterprise sector companies are divided into two parts: holding companies and subsidiaries. There are 8 holding companies in Egypt, namely: the

Metallurgical Industries Holding Co, the Chemical Industries Holding Co, the Pharmaceuticals and Medical Appliances Holding Co, the Tourism and Hotels Holding Co, the Cotton Spinning and Weaving Holding Co, the Maritime and Land Transport Holding Co, the Construction and Development Holding Co, and finally the Insurance Holding Co. Each holding company is followed by a number of other subsidiary companies, as the number of subsidiaries has so far reached about 119 companies.

In fact, some Egyptian public enterprise sector companies suffer annual losses, as a result of several production and administrative factors. The paper will attempt to discuss these factors, as follows:

First: the energy pricing problem

The demand for energy in the industrial sector is the largest among all economic sectors in Egypt, as the industrial sector needs electricity and gas to operate machinery and equipment in producing plants, especially heavy industries such as iron and steel, aluminum, and ceramics, and some companies that depend on their production on gas is like the fertilizers company, where gas is used as a raw material by two thirds, and as an energy source by one third¹.

As for electricity, the price of a kilowatt of electricity in Egypt costs industry about 60 cents, while the cost of electricity in other countries is much lower, as it costs about 40 cents in Germany and 48 cents in China².

As for the gas price, the sale price of one million thermal units has increased to \$4.5, while the average global gas price ranges from \$2 to \$2.5³.

The issue of energy pricing is one of the most important problems facing public enterprise sector companies in Egypt, as the hiking energy prices increase the cost of production factors, and thus the price of products of Egyptian industry is relatively higher than other countries. In light of the fierce

¹ Narmin Suleiman, Chemical Holding Company: 3 problems facing the restructuring of the company. Akhbar El-Youm Portal, 24 Nov 2020. <https://m.akhbarelyom.com/news/newdetails/3173339/1/-Holding-A>

² Islam Said. Electricity prices for factories increase costs and put pressure on the productive sectors.. 15 February 2020. <https://www.youm7.com/story/2020/11/15/electricity-prices-for-factories-increase-costs-and-pressure-on-productive-sectors-room/5068004>.

³ The rise in gas prices hits to kill energy-intensive industries, Youm7 14 Sept 2020. <https://www.youm7.com/story/2020/9/14/Rising-gas-prices-hit-energy-intensive-industry-in-kill/4975580>.

competition faced by the national industry, the demand for cheaper products increases. Moreover, with respect to the international market, the local market may prefer the cheaper imported products in case of the absence of import duties on imported goods (such as the case of Egypt Aluminum Company).

Thus, the rise in energy prices could lead to a decrease in companies' exports and consequently a decline in revenues, and weakening the company's financial position. It may also lead to flooding the local market with imported goods, thus increasing national companies' productive stock.

Several public enterprise sector companies, including the Iron and Steel Co, the Cement Co, the Ceramics Co, and the Glass Co have called on the government to reduce gas prices by 3 to 3.5 dollars per million thermal units, to be in line with the global gas price in various countries, stressing that these industries operate at less than 60% of its production capacity due to the high production inputs from gas, according to a statement by the Federation Of Egyptian Industries' Paper Division's Vice President⁴.

As a result, ceramic exports declined during the period (January- December 2020) to about EGP 2.269 million, compared to about EGP 2.928 million during the same period in 2019; and glass and glass products exports decreased during the same period in 2020 to about EGP 5.563 million, compared to about EGP 6.724 million in 2019, according to data from the Export Council for Building Materials, Refractories and Gold Industries⁵.

Second: Negligence of maintenance and renewal of machinery and equipment

The maintenance of machinery and equipment is one of the most important aspects that must be taken into account in any producing company, since the early days of the company's inception, as it is one of the basics of the feasibility study before establishment of any company, allocating a percentage of the company's profits to the maintenance of its machinery and equipment (known as the depreciation rate). The importance of maintenance lies in maintaining the operational capacity of

⁴ Manufacturers: Reducing gas prices for factories controls production costs and increases the competitiveness of exports abroad... Youm7, 15 Sept 2020. <https://www.youm7.com/story/2020/8/15/Manufacturers-Reduce-gas-prices-for-factories-control-production-costs-and-increase-competitive/4929441>.

⁵ The Export Council for Building Materials, Refractories and Gold Industries, 2020.

machines, contributing to increased productivity, and increasing the useful life of machines and equipment.

Unfortunately, most public enterprise sector companies suffer from severe neglect in maintenance of their plants' machinery and equipment. The Ministry of Public Enterprise Sector has announced that the metallurgical and chemical industries have suffered from great neglect in maintenance over several years, where this neglect led to the deterioration of the machines and equipment conditions, and their incompatibility with the requirements of modern production, environmental considerations, and rational use of energy, most notably the companies of fertilizers, steel, cars, tires for agricultural tractors and flanges to serve railway and metro development projects⁶.

The obsolescence of plant machines is one of the public sector's biggest problems in Egypt, and a major reason for the decline in productivity, and level in comparison with the private sector companies that are racing in search of modern technology for production, especially machines in spinning and weaving companies that date back to 1878, that have not been renewed since its inception. The aging of the furnaces used in the Iron and Steel Company also had a major role in incurring the company huge losses, as will be explained later in this paper.

Third: Financial and administrative corruption

The public sector is a fertile breeding ground for administrative deviations and financial theft, with transformation of productivity into a matter of personal interests that has nothing to do with profit and loss in public enterprises and companies, bearing in mind that it is the state that compensates losses and covers thefts⁷.

Financial and administrative corruption is one of the most serious problems facing public enterprise sector companies. This corruption entails additional costs that are reflected in the prices of the goods

⁶ Abdel Halim Salem, The Ministry of Public Enterprise Sector reveals the strategy of reform and development of its subsidiaries. Youm7, 17 Sept 2018 <https://www.youm7.com/story/2018/9/17/Ministry-of-the-Public-Business-Sector-Reveal-Strategy-Reform-and-Development-of-affiliated-companies/3953190>

⁷ Ethar Aboud Kazem Al-Fatli, Administrative and financial corruption and its economic and social effects in selected countries. Master's thesis, Ministry of Higher Education and Scientific Research, University of Karbala, 2009. <http://uokerbala.edu.iq/wp-content/uploads/2020/07/Rp-The-corruption-managerial-and-financial-and-its-effects-economic-and-sociality-in -Selected-Countries.pdf>.

they produce, which weakens their competitiveness and erodes the capital of companies. Instead of these companies being the engine of the national economy, they become a burden on the state budget⁸.

Several studies have documented the costs of corruption in the Egyptian state, indicating that the misuse of resources is one of the most serious costs of corruption, where resources are used in corruption rather than in productive means, companies waste time and resources in recruiting employees for the purpose of establishing relationships with officials and spending on bribes, and officials who make investment decisions that are biased towards a particular side away from serving the public interest⁹.

The successive boards of directors in most public enterprise sector companies have sought to reap material gains regardless of their financial status, in misuse of corporate resources. Also, they had a hand in the deliberate neglect of maintenance and renewal of machinery and equipment in plants, which led to their deterioration and low production capacity, where In the case of the Iron and Steel Company, the plant's machinery and equipment have not been maintained since its inception.

The poor oversight over departments facilitated cases of corruption in companies, where several companies incurred large annual losses, with heads of these companies not held accountable.

The privatization program that began in the Mubarak era created a complete system of financial and moral corruption through businessmen both at home and abroad with officials in the government, administration and the military. The looting of public money and waste of productive assets took place at that time through the adoption of three integrated means:

- Estimation of productive assets at less than their true market value.

⁸ Abbas Al-Tamimi, Governance mechanisms and their role in reducing financial and administrative corruption in state-owned companies. https://www.academia.edu/16670319/_Governance_Mechanisms_and_their_Role_in_Reducing_Financial_and_Administrative_Corruption_in_State-Owned_Companies.

⁹ John D. Sullivan. Corporate moral compass.. Anti-corruption tools: business values and principles, professional ethics, and corporate governance. World Bank Group. <https://openknowledge.worldbank.org/bitstream/handle/10986/23980/47791Ar.pdf?sequence=4&isAllowed=>

- Financing the purchases of these assets by borrowing from local banks, as about 40% to 50% of the sales of public companies were financed by Egyptian banks.
- Hoarding of lands belonging to these companies and selling them, or building towers or hotels on them¹⁰.

Fourth: Accumulation of Production Stock

Most public enterprise sector companies suffer from the accumulation of productive stock, due to the inability to market products, and the lack of communication between the marketing department and production operations, where the accumulation of inventory results from low demand for products while the company operates with the same production capacity.

To explain this, it is useful to address the problem of the accumulation of productive stock in an area of the public enterprise sector, that is the industrial area (value in EGP billion).

Year	End-of-period inventories of industrial production public sector/public enterprise
2005/2006	12.2
2006/2007	12.7
2007/2008	14.1
2008/2009	15.8
2009/2010	15.4
2010/2011	16.9
2011/2012	19.4
2012/2013	17.8
2013/2014	20.3
2014/2015	20.7
2015/2016	20.1
2016/2017	25.5

¹⁰ Abdel Khaleq Farouk, The Economics of Corruption in Egypt - How Egypt and the Egyptians Was Corrupted (1974-2010). Heliopolis: Al Shorouk International Library, 2011.

July 31, 2019

Source: Central Agency for Public Mobilization and Statistics (CAPMAS)

The above table indicates a general upward trend in the industrial production stock in the public sector during the period (2005-2017), where it reached about EGP 12.2 billion in (2005/2006), and continued to increase until (2008/2009) up to EGP 15.8 billion, but it decreased in (2009/2010) by 2.5%, amounting to EGP 15.4 billion, then it increased again in (2010/2011), amounting to EGP 16.9 billion, but it declined in (2012/2013) to EGP 17.8 billion, and then increased in (2013/2014) to EGP 20.3 billion, then decreased in (2015/2016) to EGP 20.1 billion, and rose again in (2016/2017) to EGP 25.5 billion, a rate of 26.8%.

The accumulation of industrial productive stock in public enterprise sector companies may be attributed to the challenges facing industries in this sector, manifested in the high cost price resulting from the high price of energy as explained above, and also due to the poor capabilities of marketing products, which resulted in the failure to sell the sector's products, as well as the distance between marketing and production.

The Case of the Egypt Aluminum Co

To apply the problems facing the Egyptian public enterprise sector companies on a vivid example, the paper chose to analyze the situation that one of the largest enterprise sector companies had reached amid fears of being liquidated as happened before with the Iron and Steel Co – namely: the Egypt Aluminum Company:

The Egypt Aluminum Company is one of the largest aluminum ore producing companies in the Middle East. It was established in 1969 as a joint stock company affiliated with the Metallurgical Industries Holding Co. The company was established for the purpose of producing, manufacturing, marketing and distributing aluminum metal, its ores, accessories, alloys, derivatives, and artifacts at home and abroad.

The company was called Egypt Aluminum Complex, as this edifice was not just a factory, but an integrated community that includes housing for factory workers and their families, and schools to serve the workers' children.

The plant was established after the construction of the High Dam with the availability of energy used in the production process for the production of aluminum ore. The factory contains 252 production cells, divided into 12 wards within 6 production lines, with each line containing 92 cells, a total production capacity of about 320 thousand tons annually¹¹.

The Egypt Aluminum Company is one of the largest producing and profitable companies affiliated with the Metallurgical Industries Holding Co, where the company operates in the field of export, generating hard currency for the state treasury, and providing many job opportunities for thousands of manpower in Egypt, whether directly or in the company itself or in other industries indirectly related to it. However, the company started to falter starting from the last fiscal year, as it turned from a profitable company to one of the losing companies. Therefore, it is important to discuss the company's financial situation, the reasons for its losses, and explain how far the company is able to overcome these losses and make profits again.

(Value in EGP thousand)

Statement	2016/2017	2017/2018	2018/2019
Net activity revenue	9094735	13502466	12190234
Net profit	1732869	2715590	570927
Exports	145.226	128.615	80.555
Wages	659658	631783	696436
No. of employees	6618	6211	5873

Source:

1- *Public Enterprise Sector Ministry*

2- *The value of exports from a study belonging to the Egypt Aluminum Company*

The company's net revenue rose from about EGP 9 billion in FY (2016/2017) to about EGP 13.5 billion in FY (2017/2018), then it dropped in FY (2018/2019) to about EGP 12.1 billion, a decline of 9.7%.

¹¹ Saber Said. 10 Information about the aluminum complex in Nagaa Hammadi... Youm7 14 Jan 2021. <https://www.youm7.com/story/2021/1/14/10-information-on-the-aluminum-complex-in-Naj-Hammadi-Produce-320-A/5156743>

The company's net profit rose from about EGP 1.7 billion in FY (2016/2017) to about EGP 2.7 billion in FY (2017/2018), with an increase of 56.7%, and then decreased in FY (2018/2019) to about EGP 570 million , with a decline of 78.9%, In the fiscal year (2019/2020), the company turned from profit to loss, as it made losses estimated at about EGP 1.6 billion.

The company's exports continued to decline from 145,226 thousand tons in FY (2016/2017) to 128,615 thousand tons in FY (2017/2018), and then to 80,555 thousand tons in FY (2018/2019).

The company referred the decline in its indicators to several reasons, including: the increase in the cost of the company's production factors, the decline in the dollar exchange rate against the Egyptian pound, which led to a decrease in the company's export revenues, and the decrease in the returns on financial investments accruing to it after the company dispensed with it to meet its financial obligations, in addition to the decline in the price of aluminum globally¹².

Electric energy is considered one of the biggest and most important challenges facing the aluminum industry in Egypt, as the company is considered one of the energy-intensive industries, and electricity represents about 40% of the price of production factors in the company¹³.

The following table shows the average price of kilowatts of electricity supplied to the Egypt Aluminum Company over the last ten years:

Fiscal Year	Average price of kilowatts (in piasters)
2010/2011	23.5
2011/2012	26.7
2012/2013	30
2013/2014	30
2014/2015	38.4
2015/2016	41.7

¹² Shaima Hefzy. 4 reasons why Egypt Aluminum Co turned a loss in 9 months, Masrawy, 30 April 2020. https://www.masrawy.com/news/news_economy/details/2020/4/30/1776258/4-Reasons-behind-the-transformation-of-Egypt-Aluminium-for-loss-in- 9-months.

¹³ Abdel Halim Salem. An official study of the Metallurgical Holding Company reveals the impact of energy prices on the aluminum complex... Youm7, 7 March 2020. <https://www.youm7.com/story/2020/3/7/ An official-study-of-the-metal-holding-company-reveals-the-impact-of-energy-prices-on/4661141>.

2016/2017	50
2017/2018	72
2018/2019	100.7
2019/2020	112

Source: A study belonging to the Egypt Aluminum Company

It is clear from the above table that the prices of electricity supplied to the Egypt Aluminum Company have increased significantly, as the average price of electricity during the period (2010-2020) increased by 419%, therefore, the average price of a kilowatt was about 23.5 piasters in FY (2010/2011), which rose to 26.7 piasters in FY (2011/2012), then it increased to 30 piasters in FY (2012/2013), then continued upward until it reached 100.7 piasters in FY (2018/2019), and finally it reached 112 piasters in FY (2019/2020).

The rise in electricity prices caused a rise in the prices of the company's production factors, which in turn affected both exports abroad and domestic sales at home, where the total production of the company is divided into 50% for exports and 50% for local production. The products imported from abroad were relatively cheaper and had a competitive advantage in the market In light of the rise in the prices of Egypt's aluminum products. The company's exports decreased, its domestic sales declined, and the company's stagnant stock increased.

In 2018, the company proposed establishment of its own solar power plant, in order to reduce the costs of production factors manifested in electricity, and asked specialized international companies to submit offers to establish a plant with a capacity of 300 megawatts through a 25-year power purchase agreement, where the generated energy would be used to provide a portion of the factories' consumption from the national electricity grid.

It was expected that the plant would reduce about 40% of the company's electricity consumption. Despite this, the Minister of Public Enterprise Sector suspended implementation of the project, claiming a decline in electricity prices by 10 piasters, which did not necessitate establishment of the

plant, adding that the company's losses were due to the drop in aluminum prices globally, not because of the high electricity prices¹⁴.

It is worth noting that in the event of reducing the prices of electricity supplied to the company, the difference in price will be paid by the state treasury from the general budget, which increases the company's burdens on Egyptian economy as a whole, where the outcome is equal in the end.

The decline in the exchange rate of the dollar against the Egyptian pound also had a negative impact on the company, given that the export proceeds of the company's products decreased. The dollar exchange rate reached about EGP 17.87 at the end of 2018, but now it has reached about EGP 15.65.

The decline in domestic sales can also be referred to the decrease in preventive measures for aluminum products on imports, which caused the local market to be flooded with imported products that were less expensive due to the decrease in production costs abroad, as explained above. Therefore, the Ministry of Trade and Industry decided to increase final protection measures on imports of aluminum products, in an attempt to save the local product.

The decline in the price of aluminum on the stock exchange had a significant negative impact on the company's revenues, as the international prices of aluminum reached about \$2,600 per ton in the fiscal year (2017/2018), but significantly declined in the fiscal year (2018/2019) until it reached about \$1,477 per ton, according to the London Metal Exchange¹⁵.

Moreover, the Coronavirus crisis affected the company after the closures and precautionary measures taken at the beginning of the crisis, which led to a decline in domestic and international demand for the company's products, and caused a state of economic stagnation in most markets.

The number of workers in the Egypt Aluminum Company was 6,618 workers in FY (2016/2017), but decreased to 6,211 workers in FY (2017/2018), and reached 5,873 workers in FY (2018/2019). As for

¹⁴ Shaima Hefzy, Egypt Aluminum stopped the solar energy project after reducing electricity prices, Masrawy,] 11 May 2020. https://www.masrawy.com/news/news_economy/details/2020/5/11/1784426/Egypt-Aluminium-Stop-Solar-Project-After-Reduce-Price-electricity.

¹⁵ Historical data - aluminum contracts. investing.com. [<https://sa.investing.com/commodities/aluminum-historical-data>].

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wages, in FY (2016/2017) wages amounted to about EGP 659.658 million, that rose to EGP 631.783 million in FY (2017/2018), and then reached EGP 659.658 million in FY (2018/2019), according to the data of the Ministry of Public Enterprise Sector.

It is worth noting that when the company plant was established, the number of workers was about 10,000, where the factory was operating with a production capacity of 120,000 tons on an annual basis, according to a statement of the head of the company's trade union¹⁶. Comparing the number of the plant workers and the factory's production capacity at the time when it was established, and their number amid the factory's current production capacity, we find the production capacity of the factory is now estimated at 230 thousand tons per year, despite the decrease in the number of workers by almost 50%. We also find that the workers are working with all their production capacity, so they have nothing to do with the causes of the company's losses.

Therefore, the reasons for the new losses incurred by the company are due to mismanagement and the failure to provide a good production environment to increase the company's revenues and reduce its losses. Also, the losses are due to the poor pricing of the energy supplied to the company, which increases the price of the cost of production and accordingly the price of the final product, which makes it unable to meet the prices of other global products, in addition to the weak government intervention to protect the national industry.

Thus, the paper concludes that the same obstacles that had hindered the continuation of the Egyptian Iron and Steel Company are existing in the Egypt Aluminum Company case, which raises the question: Are we now facing a new scenario similar to that of the sale of the Iron and Steel Company?

In fact, if the administration is not careful not to fall into the same previous mistakes, the matter will lead to a new liquidation of another public enterprise sector company in the coming few years, and Egypt would then lose a great national industry that used to achieve successive successes one day.

¹⁶ Narmin Suleiman, Egypt Aluminum Co is an edifice that fights losses, the reasons that pushed it to decline, most notably electricity, Akhbar El Youm portal 11 June 2020.

<https://m.akhbarelyom.com/news/newdetails/3154603/1/-Egypt-Aluminium-An-edifice-fighting-losses..the-reasons-that-prompted-to-retreat-most-notably-electricity>.

Conclusion

The problem of energy pricing is one of the most important challenges facing public enterprise sector companies, as it increases the cost of production factors and lowers competitiveness of the company's products in the domestic and global markets.

Companies face severe deliberate negligence in the maintenance and renewal of plant machinery and equipment, which has caused a decline in the operational capacity of machines and equipment, and a decrease in their useful life.

Companies suffer from rampant financial and administrative corruption, misuse of resources, and poor oversight of departments.

The productive inventory of companies accumulates due to the inability to market products, and the lack of communication between marketing management and production operations.

The paper analyzed the financial position of the Egypt Aluminum Company as a case study and an applied example of Egypt's public enterprise sector companies, and it has become clear that the above problems apply to the case subject to study, as these problems played a key role in the huge losses incurred by the company.

The paper concluded that the main reason behind the losses incurred by the Egypt Aluminum Company for the first time since its inception is the increase in the aluminum production cost factors, especially electricity, and that the factor of aluminum global prices is an external factor that cannot be controlled, where it ranges between up and down, while the rest of the factors announced by the Ministry of Public Enterprise Sector, particularly the dollar's low exchange rate against the Egyptian pound and accordingly the decline in investment returns, had a limited impact, in addition to the fact that the Coronavirus outbreak crisis had a negative impact on all world economies, not only on the Egypt Aluminum Company.

Comparing the reasons for liquidating and selling the Iron and Steel Company most recently, due to the accumulation of the company's losses, the inability to fulfill obligations, facing unfair competition in the domestic and global market, in addition to pursuit of personal interests, and investors' greed; the paper concludes that the same reasons may open the door to likeliness of liquidating and selling the Egypt Aluminum Company as well.