



# **The Post Privatization Development of Former Law 203 Companies**

## **15 Case Studies**

### **Special Study**

**June 2000**

Provided to the  
**United States Agency for International Development**  
by  
**CARANA Corporation**  
under the  
**USAID Coordinating and Monitoring Services Project**  
Contract # PCE-1-800-97-00014-00, Task Order 800

*Unless otherwise stated, opinions expressed in this document are those of the PCSU. They do not necessarily reflect those of USAID, the US Government, or the Government of Egypt.*

## Table of Contents

<i>Introduction</i>	2
<i>Section I: Criteria for the 15 Privatized Companies into Group A, B and C.</i>	4
<b>Group A: Noticeably Reformed Privatized Enterprises</b>	4
<b>Group B: Transitional Privatized Companies</b>	5
<b>Group C: Slow to Reform Privatized Companies</b>	6
<i>Summary Case Studies of Privatized Companies</i>	7
<i>Group A: Noticeably Reformed Privatized Companies</i>	8
Al Ahram Beverages Company (ABC)	8
El Nasr Bottling Company (Coke) and The Egyptian Bottling Company (Pepsi)	12
<i>Group B: Transitional Privatized Companies</i>	16
Ideal (Delta Industrial)	16
The Arab Company for Transistors and Electronics (Telemisr)	20
Electro Cables Egypt (Kabelat)	24
The Egyptian Financial Industrial Company (EFIC)	28
Kafr El Zayat Pesticides and Chemicals (KZPC)	32
Nasr City Housing	36
<i>Group C: Slow to Reform Privatized Companies</i>	40
The Middle East Paper Company (SIMO)	40
Middle & West Delta Flour Mills, East Delta Flour Mills and	44
Upper Egypt Flour Mills	44
Misr Free Shops Company	49
Al Nasr Casting	53
<i>Section III: Conclusions and Recommendations</i>	56

## **Group C: Slow to Reform Privatized Companies**

### **The Middle East Paper Company (SIMO)**

#### **Background: Public Sector and Law 203**

SIMO was established in 1945 as a private sector enterprise for the production of various types of paper (including duplex board, manila, and heavy grey board) and the conversion of paper and board for packaging. It was nationalized in 1961. Located in the outer Cairo suburb, Mustorid, it was one of three public sector enterprises engaged in the production of paper in Egypt.

The company was owned and operated by the Egyptian government from 1961 until its privatization in 1997. It was an affiliate of the Ministry of Industry (which also appointed the company's Chairman) and its business was supervised for the government by the General Egyptian Chemical Industries Organization (GECIO). The company produced output to targets set by the Ministry, and cooperated with the two other public sector paper companies in meeting the government's over-all business plan for the sector. There was no competition between the different paper companies and the price for their product was set by the government and kept below the international market price. The company itself was managed by highly qualified line engineers and chemists, was supplied by GECIO with modern machinery during the 1970s and 80s, and developed the largest production line of heavy cartons in the Middle East.

The company employed around 1100 people, whose work-place position was protected by the public sector labor codes, and like the other government enterprises discussed in this study, was well over-staffed by redundant employees. SIMO's management had some enterprise level autonomy from the government and although the price for paper in the domestic market was set by the government, the sales and distribution functions of SIMO's business were to some degree decentralized from state control. The state acted as an intermediary linking SIMO's production to would-be clients in both the public and private sectors and did not engage in the practice of bulk purchasing of SIMO's production, as it did in the case of some of the other SOEs, particularly those in the agricultural sector.

SIMO's business practice was further liberalized during the early to mid 1990s, when the company was re-incorporated under Law 203 and became an affiliate of the Holding Company for Chemical Industries (HCCI). Like other Law 203 state owned enterprises, SIMO was encouraged by the state to be independent both financially and in terms of management and the price for its production was no longer set by the government but was now determined by the international paper market. The company began to export some of its production to neighboring countries (it adopted the ISO for internationally recognized production standards), as well as implement labor restructuring policies (ie, undertook an early retirement program in an effort to reduce some of its redundant workforce).

#### **Privatization: Date and Method**

The company was offered by the HCCI and the National Investment Bank (co-owners of the company since 1995) through an IPO on June 18<sup>th</sup> 1997. This transaction resulted in the sale of 85% equity that the government held in the company

### Ownership Structure/Corporate Governance

The privatization created a new ownership structure at the company, where the main stake holders in the enterprise were now:

- 48% to The Diyya Group
- 22% to The Khorafy family
- 15% to the Holding Company for Chemical Industries
- 10% to the Employees (ESA)

The transaction led to substantial re-organization on the company's Board of Directors, including the elevation of two individuals from the Diyya Group to the Board and one from the Khorafy group. The Holding Company retained two positions on the Board (including the Chairman, Mr Moustapha Magdi) and the ESA was allocated one position. The privatization of SIMO was the first transaction effected through the capital markets where one group of private sector investors were able to take a commanding stake in a privatized SOE and appeared poised to take control over management away from the Holding Company.

Between June 1997 and April 1998, the ownership bloc headed by Ahmed Diyya Hussein (48% equity in SIMO) acquired more equity in the company, raising its stake to 55% and on April 1<sup>st</sup> 1998, Ahmed Diyya became SIMO's Chairman of the Board. However, during the ensuing months, corporate governance and industrial relations problems engulfed the company. SIMO was working profitably at the time of the privatization and was in reasonable financial condition - though susceptible to the volatility of price fluctuations in the international paper market. As the price for SIMO's product began to fall on the international market, the company's sales declined. By the end of 1998 SIMO's profits declined sharply and the company incurred losses of 2 million LE. The company's financial position deteriorated to the extent that its employees were not being paid their basic monthly wage during certain periods of 1998, leading to a tense atmosphere between the employees and the company's major shareholder.

The tense atmosphere deteriorated further as rumor began to spread quickly at the enterprise that Ahmed Diyya was now exercising the intention of closing either some – or all – of SIMO's production line/paper factories and employ the company's land assets for alternative commercial purposes. The tense atmosphere and the deteriorating financial position of the company reached a climax at the end of 1998 at a time when the company's internal problems could not be resolved between its major shareholders, senior management and the employees. The HCCI, still one of the major shareholders in the company with a 15% equity stake, made a recommendation to the *Musllahat Al-Sharikat* (the Companies Authority in the Ministry of Economy), that SIMO's Board of Directors (including its present Chairman, Ahmed Diyya) be temporarily suspended and that a new Chief Executive Officer (CEO) be appointed by the government to run the company. This administrative measure undertaken by the Holding Company and the Companies Authority, which effectively suspended SIMO's Board of Directors, resulted in the removal of Ahmed Diyya from his position as SIMO's Chairman and his replacement by a government appointed CEO, Engineer Taha Abd-Al Roba.

Abd Al-Roba was seconded from the National Paper Company in Alexandria (a Law 203 affiliate of the Holding Company for Chemical Industries), and was given a mandate by the government to rehabilitate SIMO's financial status to its previous position. The measure was intended to be of a transitional nature and the government has alluded towards the intention of reinstating SIMO's

Board of Directors once the company's operational and financial position is once again at a satisfactory level. However, while together the Khorafy family and the Diyya Group still maintain an equity stake amounting to around 77% of the company, under the current arrangement they are prevented from exercising any influence over SIMO's management or major corporate level decisions. In essence, they are currently prohibited from exercising their basic rights as shareholders. This is particularly distressing for Ahmed Diyya who currently owns 55% in the company and has filed an appeals case at an industrial tribunal. The case is pending and remains unresolved to this day.

### **Management/Operations**

As SIMO has been in essence "re-nationalized" since the end of 1998, the company has only been effectively under private sector control during the period April-December 1998 – a period which itself was hardly conducive to undertaking any serious managerial or operational restructuring. Hence there are presently no new non-government managerial appointments at the company, nor are there any evident operational adjustments resulting from the initiatives undertaken by the company's private sector shareholders. While the government has alluded to its intention of re-instating the company's Board of Directors, there is no tangible evidence of any plans to restructure the public sector management system which presently governs SIMO's operations.

It is evident that Ahmed Diyya had his own vision for running the company since he began making a number of changes in management personnel after he became Chairman. However, after the administrative measures taken against him by the Holding Company and Companies Authority, these individuals have since been removed and their place taken by persons appointed by the Holding Company.

### Financials

Since the removal of Ahmed Diyya from the position of Chairman of SIMO's Board of Directors, the company's loss making position has improved, and losses have been minimized to 150,000 LE during 1999-2000, as compared to 2 million LE during April-December 1998. There have been no new financial policies implemented at the company however and the Central Auditing Agency remains SIMO's chief auditor, as is the case with public sector enterprises and other companies where the government holds a significant ownership stake.

### New Capital Investment

There have been no new evident investments made into the company from its private sector shareholders.

### Changes to Public Sector Corporate Culture

While SIMO remains in the odd position of being a private sector owned, public sector managed enterprise, its corporate culture has retained the flavor of the public sector. The company's grounds in Mustorid, are littered by large volumes of decaying paper and other residual products and are in need of refurbishment. Management titles employed at the company reflect the status oriented political appointments made under the public sector and are still, for the most part, in

place. The company's employees, many of whom have spent their entire careers with the enterprise, continue to associate with the pan-public sector labor organizations and their colleagues in the two other public sector paper producing enterprises, rather than with the private sector. They continue to observe the hours of the public sector work regime. Further, it can be added that they see the HCCI (ie, the government) as a form of protection as well as representation of their interests, particularly after the manner in which their wages were withheld during Ahmed Diyya's time as Chairman of the company, and the industrial unrest which subsequently resulted.

Given the problems that have occurred at SIMO, and its dearth of experience with the operational culture of the private sector, it is perhaps not surprising that the present CEO of the company has suggested that in developing countries like Egypt, it is important to have the public sector controlling mainstream industries which hold broad significance for society, including the paper production. The present CEO appears to be playing more the role of a civil servant than a senior level businessman, since he refers to his present position at SIMO as a transitional one, where he was asked by the Holding Company (ie, the government) to come across from the National Paper Company in Alexandria to help put things back in place for the government at SIMO, before returning back to Alexandria when the situation at SIMO returns to what the government may consider "normality".

#### Labor, Wages and Compensations Packages

The basic Public Sector wages and benefits package, together with its labor and employment codes, continue to provide the base framework for employee-employer relations at the company. There have been no wage increases for SIMO's employees outside of the automatic public sector annual increases enjoyed by employees in the public sector proper.

#### **Concluding Comment.**

The post privatization experience of SIMO gives a strong indication of the degree of power that the state can exert over majority privatized enterprises. It shows that even where the private sector gains a single majority ownership consortium within a privatized company, the state is still in a position to exercise a controlling hand in corporate governance – even if its stake in the company is substantially smaller than that of the private sector shareholders. The lack of transparency around the government's take over of the company in late 1998, and the state of uncertainty in which it has left the company's main shareholders is particularly distressing for a country seeking to expand its privatization program and attract foreign investment.