Small Enterprises in Egypt and the Institutional and Regulatory Framework: Focus Group Discussions' Findings and Analysis

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I. Background & Introduction

Local and international research and experience has shown that one of the main impediments facing small businesses is the high cost of compliance with the legal and regulatory framework. This high cost of compliance served to push the vast majority of entrepreneurs in the developing world into informality. Egypt is one of the countries with a complex legal and regulatory environment and, not surprisingly, a large incidence of informality among the ranks of the private sector. For example, according to the Chairman of the Chamber of Food Industries, 80% of the production of this vital sector is currently being undertaken by informal and unregulated businesses.

In this sense there seems to be a marked incongruence between the market realities on the one hand and the legal, regulatory and institutional framework regulating this market. In the course of exploring this incongruence the report reveals the extent to which the institutional framework supports or restricts entrepreneurial activity of the small enterprise sector.

Informality is not only limited to the legal status of businesses. Rather it extends to encompass various aspects of daily business practices and transactions. The objective of this report is to shed some light on some of these aspects and practices and their causes as well as problems faced by small entrepreneurs[1] with regards to the legal and regulatory framework, as well as the manner in which it is administered. In so doing the report qualitatively tests some of the assumptions and hypotheses developed and/or adopted by the ILD & ECES in the course of their work on business formalization in Egypt. The conceptual framework adopted by the ILD depicts the following "Institutional Pillars for Market Expansion and Economic Development"

1. Clear, secure and transferable property rights;
2. Safe and enforceable contracts;
3. Updated information on economic agents, assets, and contracts; and
4. Efficient dispute resolution mechanisms.

To these pillars are related a set of assumptions/hypotheses pertaining to the behavior and practices of entrepreneurs. While not seeking to address all of the above pillars or their corresponding assumptions, this report

[1] For the purpose of this report a small enterprise is defined as the enterprise which employs 5 to 20 workers.

addresses some of these assumptions/hypotheses. These include inter alia:

1. The entrepreneur wishes the recognition of his/her business in the legal market.
2. The entrepreneur wishes to burden his/her real estate property title to get a loan.
3. The entrepreneur wishes to present financial information on his/her business.
4. The entrepreneur wishes to protect him/herself using limited liability status.
5. The entrepreneur wishes to raise investment funds against equity for issuing shares.
6. The entrepreneur wishes to obtain finance by issuing bonds or pledging assets.
7. The entrepreneur wishes to pay predictable taxes.

II. Methodology & Profile of Participants

The report is the product of eight focus group sessions conducted with some 62 entrepreneurs from Cairo, Giza, Qalubiya (Greater Cairo), Sharqiya, Damietta and Alexandria. It should be noted that five of these focus group sessions were conducted with 43 participants from the Greater Cairo area, hence implying a potential bias. However, no fundamental differences were detected between the different governorates. The participants (see Annex I.) fell in the following categories:

Activity/Sector	Number of Enterprises
Leather Products Manufacturing	5
Garments Manufacturing, Spinning & Weaving and Embroidery	8
Marble	2
Vehicle Maintenance	6
Restaurants	4
Wholesale & Retail Trade	9
Food Processing & Packing	6
Furniture Manufacture	11
Aluminum, Glass and Mirrors	4
Others (geometrical modeling, filters & pipes, metal casting, batteries equipment manufacturing)	7
Total	**62**

Most of the clients (43 from Greater Cairo and 7 from Sharqiya) were selected from amongst the small enterprise clients of the SME lending foundations established by USAID in these governorates. A Discussion Guide was prepared to reflect the issues addressed by ILD. The Guide was largely divided into four sections:

1. Buying & Selling (Cash vs. Credit).
2. Financing Needs.
3. Real Estate and Business Practices.
4. Obstacles Posed by the Legal and Regulatory Framework

Rather than seeking to present a quantitative analysis of the issues, the findings in this report should be taken to be indicative in nature, rather than representative of the entire small enterprise universe. Accordingly, where figures and/or diagrams are presented, it is done only for illustrative purposes. Even though they should not be taken to be exact or representative, it is believed that they are sufficiently indicative to merit the attention of development experts and policy makers.

III. Findings & Analysis

A. Buying & Selling on Credit

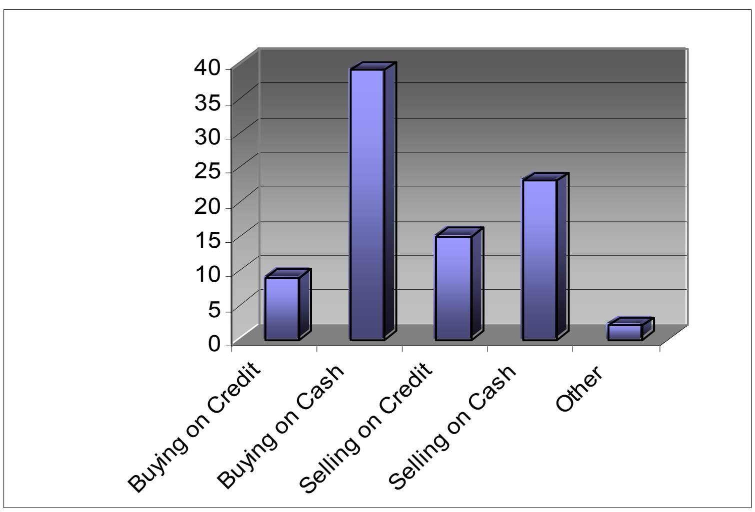

Figure 1: Entrepreneurs Buying & Selling on Cash vs. Credit

As the above diagram shows, most of the SMEs participating in the focus groups buy and sell on cash. While there is a sizeable minority that indicated that they sell on credit, a small minority indicated that they bought their requirements on credit. Most of those who sell on credit were garment factories and wholesalers.

Generally speaking there was a consensus that buying and selling on credit has lately been progressively decreasing. This is due to several interrelated reasons:

1. *Recession & Lack Of Liquidity:*

Several entrepreneurs reported that the current recession (which has seemingly been going on for years) and the lack of liquidity, are the main reasons for the decline in buying and selling on credit.

2. *Risk*

With the reported recession, it is natural for default rates to rise. Hence the risk associated with buying and selling and credit would increase leading sellers to refrain from using credit.

3. *Ineffective Legal Procedures.*

<u>Recession</u>

Recession was a major source of complaints during discussions with entrepreneurs from the various sectors. Enterprise level impacts of recession reported by entrepreneurs included significantly declining sales revenues, and profit margins[1] that resulted in a corresponding decrease in the enterprise workforce (one entrepreneur, a garments manufacturer, reported a 70% decline in both sales and number of workers). Other measures reported were decreasing the workers wages. A restaurant owner reported a decrease of 60% of its workforce, coupled with lowering the workers wages to compensate for the declining sales. Some factories reported producing and selling on cost in order to keep the equipment running.

Many reported the legal procedures associated with bad checks are both costly and lengthy, in addition to their being ineffective in retrieving the money. With the end result being the imprisonment of the creditor, there was no perceived reason or inherent benefit in taking legal action. This is especially the case given the consensus of virtually all participants that it is highly unlikely that a creditor would default on purpose, while he can actually pay back the loan or the amount due. All participants stressed that in the market the reputation of the entrepreneur is his biggest asset. Purposefully defaulting on a loan, while having repayment ability, is highly unlikely.

The recession and the widespread phenomenon of bad checks and debts resulted in the emergence of an informal factoring practice that increasingly gained visibility in the market. Lawyers buy the bad checks at a reduced price and follow legal proceedings on their own. An entrepreneur in Alexandria tells the story of a bad check that he had for the amount of L.E. 10,000, which he sold to his lawyer for L.E. 7,000.

4. *Higher Cost*

Several respondents argued confirmed that buying on credit increases the cost of inputs, since a mark-up is often placed on the price in case of payment on credit or by installments, especially if installments are paid over a long term. This mark-up usually takes the form of a discount or a bonus percentage for cash payment.

5. *Sector specific conditions*

It might be the case that in certain sectors, the lack of raw material places the seller of raw material in a strong position whereby cash payment is dictated. A case in point according to one leather manufacturer is raw leather; most – and the best - of which is exported, leaving a small portion of lower quality to the local market. Due to intense competition on acquiring the remaining leather cash payment is dictated by leather traders. In addition, the short duration of the business cycle in some sectors makes cash a more attractive alternative.

Several cases reported buying their needs on both credit and cash bases. These however bought the majority of their needs on cash, with supply credit, constituting a small portion of their operations. A very limited number reported buying most or all of their needs on credit. For example, in the case of an ice-cream distributor in Cairo, the entire cycle is credit-based. The wholesaler takes the supplies from the factory on credit (against a letter of guarantee), and is paid by the retailers on credit basis, thus resulting in no significant liquidity constraints for the enterprise. Other entrepreneurs indicated that they try to keep the credit portion of their purchases to very short-terms or limited portions of their purchases that don't usually result in an additional mark-up on the original price.

Informal Assets: Reputation (El-Som'aah)

All participants stressed that in the market the reputation of the entrepreneur is his biggest asset. Purposefully defaulting on a loan, while having the repayment ability, is almost out of the question. As one Socks factory owner puts it, "being a well-known factory, in addition to my good reputation, allows me to purchase about 30% of my needs on credit, and I pay back within 6-7 months"

This however has not always been the norm. Several entrepreneurs reported their buying their needs on credit in the past, suggesting that this shift to transaction that are heavily cash-based is a relatively recent trend.

Selling on credit, while acknowledged to be of high risk, was more widespread than buying on credit (see figure 1, above). Here a differentiation is made between selling on installments (*belta'aseet*) and selling on credit (*bel'agal*). The liquidity/recession problems currently faced by the economy caused many to suffer from late repayments. One sector that was hard hit by the recession is the construction sector. According to a Cairo pipes distributor he couldn't cash the checks of several clients, mostly contractors doing construction works for the public sector. An Alexandria entrepreneur specializing in aluminum windows and doors recounts how he worked hard for five years on a touristic village on the North Coast. With the government defaulting on its payment to contractors, he, as a subcontractor, was not paid till the time of the focus group discussion.

Another leather manufacturer specializing in industrial safety apparel gets repaid by the government in installments over almost a year. This places him in a tight financial situation, since he pays for almost all of his inputs in cash, except in very few situations where he takes his input on very short-term credit terms (from 3 weeks to 2 months). Again, the reputation of the entrepreneur is the key guarantee. Although this seems to be widespread among those that deal with government agencies, it is also the case with some whose clients are private businesses. According to one manufacturer of mechanical and electrical equipment used for car batteries, "three years ago I used to receive my money within a week of submitting the invoice, now I have to wait for 6 months before receiving my money. I even have a check that is 9 months overdue."

Here it should be stressed that in the above cited cases, no mark-up is added to the original price, even in case of late payment. The case is different in cases of retail selling on installments, where a mark up is added to compensate for the delay in full refund. For example in the case of a furniture manufacturer, this mark-up reaches 25%. An embroidery workshop charges an additional 20% if selling on credit[2]. Almost half of

Informal Market Mechanisms

The "wagba dayra" (rotating meal) practice is an informal mechanism that was reported by some food processing and wholesaling enterprises. By virtue of the wagba dayra system the wholesaler/factory provides the retail shops with a first round of their requirements without getting paid in return. Upon providing them – after some time – with a second round, he is refunded for the first round. This way the retailer always owes the supplier money for one round, and it's reportedly never actually refunded. A confectionary who follows the same system in his dealings indicated that in his case he doesn't adopt this system during high seasons (e.g., school season).

[2] This can be compared to the prevailing bank interest rate is 15-16%. However, bank loans are not widely and easily accessible and the transaction costs may make them prohibitively expensive for the majority of consumers.

the enterprises sales are done on credit basis. In these cases the purchase is usually supported by the required documentation (checks or IOUs). The duration of the period over which full payment is expected to be made naturally varies by product.

B. *Financing Needs*

1. Working Capital:

Most participants in the focus groups indicated that they obtained their capital requirements primarily through self-financing, followed by informal mechanisms, including:

1. Game'iyat [rotating saving and credit associations (ROSCAs)].
2. Informal loans (an entrepreneur reported an annual 40-60% interest rate)
3. Interest free loans from family, neighbors or friends.
4. Limited deal partnerships (partnerships limited to one business deal)
5. Selling personal belongings.
6. Self-financing (from enterprise revenues).

While game'iyyas seem to be the most widespread informal financing mechanisms, the lack of documentation and guarantees may on occasion render it unreliable. The gameiyya largely relies on reputation, peer pressure and careful selection of its members. The gameiyya is interest free. However, some interest-bearing ROSCAs were revealed to exist in other developing countries[3].

2. Partnership as a source of financing

Overall, most SME participants weren't in favor of taking in partners to expand their operations. Generally it seems that technicians and craftsmen were mostly opposed to the idea of having a partner, on the grounds that "*mafeesh fil sana'ah sheraka*" (no partnerships in crafts). The rationalization of this response is that for a partnership to be fruitful both partners must have the same ambition and skill level, which, they believed, is highly unlikely. In addition, most entrepreneurs wouldn't accept having somebody intervening in their business, "just because he puts in money". Where the concept was acceptable it was largely on temporary basis, covering only a single business deal.

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[3] Ministry of Economy, A Draft National Policy for Small and Medium Enterprise Development in Egypt, Cairo, June 1998. p. 18

Most of the entrepreneurs that had partners had family members and relatives as partners, and mostly to lower the taxes they're subjected to, rather than to actually co-finance and/or co-manage operations. Some entrepreneurs recounted unsuccessful experiences with partnerships.

In fact, only two cases accepted having a partnership to leverage their resources, one of which qualified this acceptance by having the partner not involved in management. Only a single entrepreneur indicated that he's actually entering a partnership in order to leverage the financing of his operations and seemed accepting of the fact that the partner has to participate in managing the enterprise operations.

C. ***Collateral & Real Estate***

As the diagram below shows, the majority of the respondents (about 55%) interviewed rent their business premises. Around one-fifth own their premises, and a quarter have both owned and rented premises (more than one premise per entrepreneur). These findings are roughly close to an earlier (1995) estimate of 85% of businesses operating from rented space, as reported by the World Bank[4]

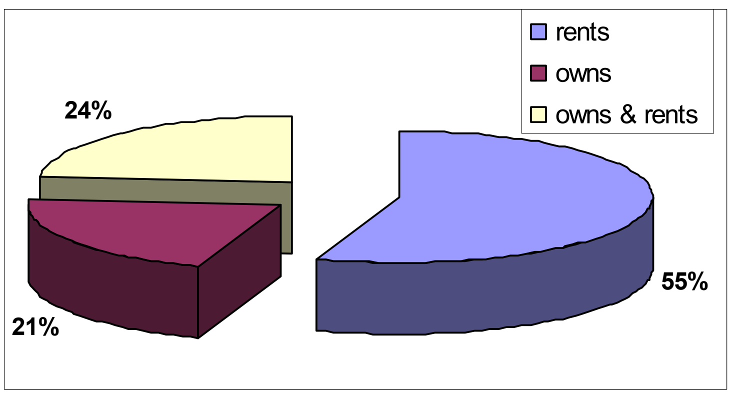

Figure 2: Owners vs. Renters of Premises

The idea of using their premises as collateral, against which they can get a loan to expand their business does not seem to be well-entrenched among small entrepreneurs. Discussions with participants revealed several dimensions of their perceptions of, and experiences with, the banking sector.

Apparently few SMEs attempted to approach banks for loans. These attempts were largely unsuccessful, in many cases despite the existence of sufficient collateral. A wholesaler recounts his experience with the Social

[4] The World Bank, Arab Republic of Egypt, Economic Policies for Private Sector Development, V.2, May 19, 1995, p. A. 57

Fund for Development, El-Ahly Bank and Banque Du Caire, whereby, despite the fact that he had collateral as well as a feasibility studies, and the approval of the SFD, his request was turned down without giving reasons. A garments manufacturer who presented an entire building as collateral was likewise denied a L.E. 100,000 loan. A cheese manufacturer had to spend two years before the bank officially denied his request, even though he had the necessary documentation and collateral. In the case of a marble factory owner, the bank offered to provide him with the equipment, rather than extend a loan. A similar experience was recounted by a restaurant owner who, after presenting her shop as collateral for a requested loan of L.E. 70,000 obtained an approval for the smaller amount of L.E. 10,000 for the purpose of buying equipment. Several participants believed that bank employees approve only large loans so that they can take a percentage as a bribe[5]. In fact these allegations of corruption were not only related to banks. A glass and mirrors workshop owner in Alexandria claims that a credit officer in a national program asked for 10% of the total loan value in order to facilitate loan approval.

By now it is well known that formal financial institutions refrain from lending to SMEs because of several reasons. These include, among others, predominance of collateral-based lending (as opposed to cash-flow-based lending) at the time when SMEs lack such collateral, SMEs' lack of accurate and adequate financial books and record, the perceived high risk of lending to small businesses (due to SMEs' high failure rates, coupled with the lack of capacities on the part of banks for proper screening and selection of clients). More fundamentally, given the banks' traditional overhead structure, processing and monitoring small loans becomes uneconomic.

This dissatisfaction with the financial system is not only related to credit services. An entrepreneur recounts how a public sector bank refused to issue him a check book except after they scrutinize his business dealings; a process they estimated to take 6 months. In less than 10 days, the entrepreneur was able to have a checkbook from a private sector bank.

Overall entrepreneurs who rented their premises felt no need to own it. This was especially the case with those who rented their premises under the old rent laws, and hence paid relatively small rents, and had rights that are almost close to those of ownership. Few of them thought of taking loans, and even fewer thought of using their premises as collateral. In fact, several argued that it's better to use the money to buy equipment and to run the business than buy premises. In addition, according to several entrepreneurs, there is no specific need to offer the business premises as

[5] Allegations of corruption, it should be noted, were also made against SME lending programs.

collateral. Any other collateral can be offered to the bank; e.g. the workshop or the machinery.

D. ***Compliance Problems***

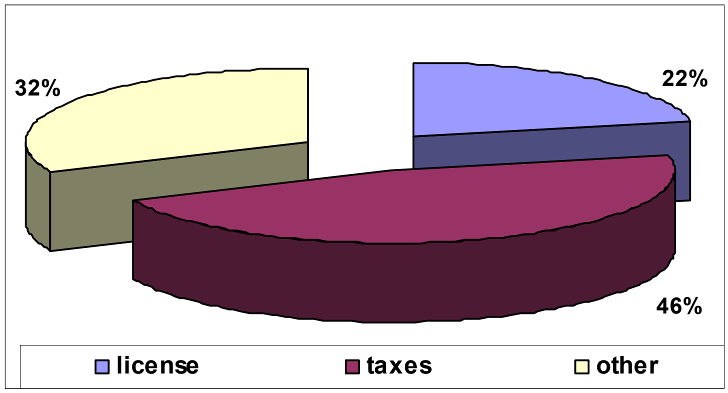

Figure 3: Compliance Problems Faced by Entrepreneurs

Entrepreneurs reported a variety of problems they encountered due to the laws and regulations and their administration. These included:

1. *Taxation & Tax administration*

Almost all entrepreneurs agreed that the tax authority usually arbitrarily estimates taxes, regardless of whether or not they keep regular books, thus resulting in overestimated taxes. Making an appeal before a committee in order to lower taxes is the rule rather than the exception. A Cairo mechanic tells the following typical story:

> "The tax authority estimated that I have to pay L.E. 36,000, based on their assumption that I earn a daily profit of L.E. 40, when in reality I make just L.E. 10 per day. Upon appealing this estimate an agreement was reached that I should pay them only L.E. 8000."

A retailer in Sharqiya specializing in women's make up and briefcases complains that the Tax Authority assumed that the products he sells are rotated four times per year, irrespective of the market conditions.

Another example of the way the Tax Authority estimates taxes is recounted by a wholesaler, whose tax dues were inflated on the false grounds that he sells cigarettes, even though he doesn't sell tobacco at all. According to one marble manufacturer, the Tax Authority arbitrarily determines the tax estimates based on the capacity of the machinery in the factory, regardless of the actual production, or the market conditions.

Most of the participants accordingly perceived no real need in keeping accurate books. In order to manage their operations however they document their transactions in a regular notebook. Moreover, while the larger more sophisticated ones had their chartered accountants, and in one of the cases – a wholesaler – a computerized accounting system, this did not seem to have a bearing on the procedure of appealing or on the estimates made by the Tax Authority. This pattern was widespread among entrepreneurs irrespective of their sector, size or location.

Several entrepreneurs report that employees in the Tax Authority (as well as most government inspectors) come to inspect their premises during certain seasons (feasts, summer vacations, and before the beginning of the school year) in order to generate additional income for themselves through bribes. According to one Damietta furniture manufacturer, "when a tax inspector passes by, we all close down our shops and hide".

The administration of the sales tax was another source of complaints, especially amongst furniture manufacturers. Owing to the fracturing of the value chain of furniture production across different workshops, the sales tax is applied at each stage of production. Reportedly, a 10% tax is levied on each of the importer of wood, the distributor of wood, the wholesaler, and the furniture exhibition.

2. *Operating License*

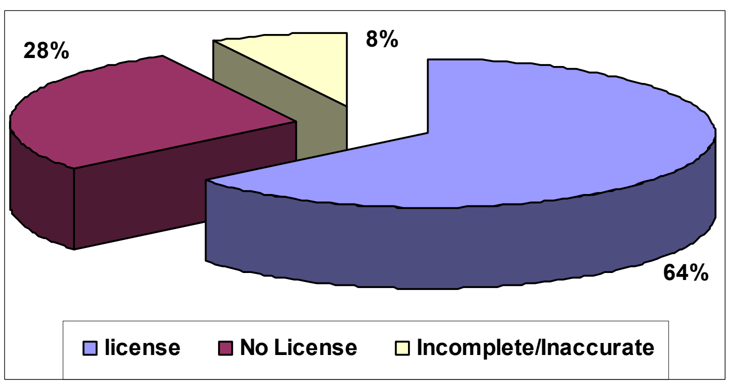

Figure 4: Compliance with Licensing Requirements

The above figure shows the status of the entrepreneurs participating in the focus group discussions with regards to licensing. While 64% reported that they have licenses, the Team believes the true percentage to be lower, since some entrepreneurs may be afraid to reveal that they operate informally.

"I don't have a license or any other official documents and I don't issue invoices; I don't like to deal with the government"

A Cairo Leather Products Manufacturer

The issue of licensing is both sector and location sensitive. Zoning regulations prohibit the establishment of certain business activities in certain locations. The repercussions of not issuing the license were also found to vary by location and size, whereby very small enterprises or those located in areas that are difficult to reach and detect by government inspectors seem to face less compliance problems than the more visible ones[6].

In fact, for some of them compliance with the licensing requirements leads to financial losses. For instance, for a mechanic currently located in a residential area to obtain a license he has to relocate to an industrial district, which translates into higher costs of acquiring and refurbishing the shop, as well as loss of customers that are either largely drawn from the immediate vicinity, or have grown accustomed to commuting to the enterprise location. A wholesaler complains that since he obtained the license he was forced to open and close at fixed hours, which, he claims, affects his business.

One measure of the cost of compliance seems to be reflected in the difference between the price of a licensed shop and that of an unlicensed shop. In 1995 the World Bank estimated the average key money cost (*khelew regl*) of a licensed shop to be 30% higher of an unlicensed one[7]. A mechanic reports a larger difference between the price of an unlicensed shop in Souk El-Oboor district (L.E. 7,000) and the licensed one (L.E. 150,000).

The inability to obtain a license did not seem to prevent entrepreneurs from operating their businesses. An embroidery factory has been in operation for more than 13 years without issuing a license. Another metal casting factory owner who has been operating for 10 years reports that he neither has a license, nor does he know how to obtain it. These entrepreneurs choose to adopt a variety of tactics including:

1. Bribery.
2. Paying fines.
3. Closing the shop when inspectors are reported to be in the district.

Some entrepreneurs chose to bribe district officials to get a license or obtain a license that does not cover or reflect all their operations. For example, a glass and mirrors manufacturer reports paying a bribe of L.E. 1,000 in 1984 to obtain a license for selling only, rather than both manufacturing and selling. A leather manufacturer had to pay a bribe of L.E. 700 to obtain a license for operating leather using manual equipment

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[6] In fact there is evidence suggesting that the administration of many aspects of the legal and regulatory framework appears to be location sensitive. Due to the way some pertinent government departments are structured (along geographic lines), there is a room for locational variations in performance of their functions.

[7] Ibid, p. 111.

and tools only, despite the fact that the approved factory's layout depicts the machinery.

The following table presents some examples of the bribes paid by entrepreneurs in Cairo to obtain their licenses. A higher estimate was provided by a confectionary, who, two years ago (in the year 2000), had to reportedly pay a bribe of L.E. 16,000 for the same purpose.

Activity	Amount Paid (L.E.)	Location	Year
Glass & Mirrors Manufacturer	*L.E. 1,000*	*Manial*	*1984*
Restaurant (Koshary)	*L.E. 5,000*[8]	*Khalafawy*	*1999*
Wholesaler	*L.E. 200*	*Sharabiya*	*1992*
Leather Products Manufacturer	*L.E. 700*	*Shubramant*	*N/A*
Bakery	*L.E. 14,000*	*Montaza, Alexandria*	*2001*
Car Electrician	*L.E. 4,000*	*Montaza, Alexandria*	*N/A*

4. *Supplies Inspectors*

Several participants, especially those working in trade and food processing, complained from Ministry of Trade & Supplies inspectors. Several reported unjust and arbitrary practices by the inspectors who on more than one occasion would ask the entrepreneur to choose a fine to pay, simply because they have to collect fines. The usual practice is for entrepreneurs to choose the fine for not posting a price list, even when a price list is actually posted, because it's the lowest fine. In fact one of the wholesalers argued that it's a blessing if the supplies inspector charges him for not posting a price list.

"The inspector examined everything in my shop, and after he couldn't find a flaw with my operations he looked at a handful of dried raisins that I use and asked about their expiry dates. I replied that I got them from the supermarket across the street. Without examining the raisins, he fined me for using raisins that exceeded their expiry date."

Another source of complaint is the multiplicity of departments within the Ministry of Supplies with overlapping mandates. According to a cheese manufacturer: "There are seven departments within

[8] The entrepreneur was unable to pay the amount and hence resorted to pay L.E. 100 every two weeks to keep the municipality inspectors away from his premises.

the ministry that perform inspections with overlapping mandates…I am accustomed to paying a fine twice a year".

Entrepreneurs also felt that they were being fined for things outside their control. A wholesaler who went to court for selling tuna that had fish bones in it complains that he did not manufacture the tuna cans, and that the manufacturer is the one that should be fined.

5. *Social Insurance*

Social insurance regulations and inspectors were another source of complaints, especially among manufacturers. First, as the next table shows, the level of compliance with the social insurance requirement of registering all workers in the enterprise seems to be remarkably low.

Activity	Total Number of Workers	Number of Insured Workers
Glass & Mirrors Manufacturer	13	6
Embroidery & Garments	25	5
Mechanic	8	2
Furniture Polishing	6	0
Furniture Gold Polishing	8	0
Furniture Manufacturing	15	0

The reason for this low level of compliance is not only the entrepreneur's desire to minimize expenses. Rather, it seems that workers do not value the insurance service as much as they value retaining their portion of social insurance.

As far as the inspection process is concerned, several entrepreneurs complained from the unjust practice of counting all those who happen to be at the enterprise at the time of inspection as workers and requesting to see evidence of their social insurance registration.

6. *Others*

These include municipalities (baladeyya), environmental authorities[9], the district (el hay), electricity inspectors and health inspectors (el sehha), in addition to police officers. These were found to be location sensitive. In Damietta for example, complaints from electricity inspectors were

[9] This seems to be a significant source of complaints, since the fine is L.E. 1001, in addition to possible imprisonment.

recurrent, while in Alexandria the district (el hay) was called by the entrepreneurs "hay el Kuwait" (literally, Kuwait district), implying that district officials make as much money through bribes as Egyptians who worked in Kuwait in the 1970s used to.

IV. Conclusion

Overall there is marked incongruence between the institutional and regulatory framework on the one hand and market realities on the other. The above analysis shows that entrepreneurs have to deal with a myriad of obstacles that they can only overcome through bribes or other time and money consuming confrontations with the system. The complicated laws, together with the overlapping mandates and multiplicity of government departments an entrepreneur has to deal with constitutes fertile grounds for corruption and extra legal (if not illegal) practices. Not only does the system render the establishment of an enterprise and the initiation of economic activity at best challenging, but small entrepreneurs also find themselves engaged in such confrontations and struggles with the system throughout the enterprise life.

However, based on the above analysis and findings, and given the indicative nature of qualitative research, this report suggests that while the four "Institutional Pillars" outlined in the ILD's conceptual framework are largely valid, some of the assumptions/hypotheses pertaining to these pillars are inaccurate.

1. *The entrepreneur wishes the recognition of his/her business in the legal market.*

This hypothesis, while not directly tested, was not unequivocally supported by the research conducted. For example, a significant portion of entrepreneurs choose not to issue a license, regardless of the repercussions. Apparently, the cost of such recognition for them outweighs the benefits. In fact, one of the cases argued that by getting this legal recognition, he is being subjected to more injustices, being under the tight control of government officials.

2. *The entrepreneur wishes to burden his/her real estate property title to get a loan.*

This hypothesis, as the section on real estate (II.C.) shows, is largely unsupported. The vast majority of entrepreneurs operate from rented space, which they cannot use as collateral. Furthermore, only a minority of small businesses considered approaching a bank for a loan. Their experience suggested that the main reason for not obtaining the loan is not as closely tied to collateral and legal titles over property as might have been thought. Even if the entrepreneur has legal title to a real estate property, the cost of acquiring this property by the bank seems to be high compared to the size of the loan (and hence the revenue the bank would generate from the loan).

3. *The entrepreneur wishes to present financial information on his/her business.*

Only a minority keep adequate books of their operations, largely because their experience with the practices of the Tax Authority strongly suggests that it is irrelevant to whether they do or do not keep and present adequate figures. To them keeping adequate and approved books constitutes an added cost, that again, outweighs its benefits.

4. *The entrepreneur wishes to raise investment funds against equity for issuing shares.*

Very few entrepreneurs were willing to accept the idea of having partners, except to evade taxes or as a last resort and mainly in this case on a single deal basis.

5. *The entrepreneur wishes to obtain finance by issuing bonds or pledging assets.*

As explained above, entrepreneurs who rented their premises saw little value, if any in acquiring their premises (the main form of assets banks deal with in Egypt).

6. *The entrepreneur wishes to pay predictable taxes.*

This report suggests that the above hypothesis holds true. Arbitrary estimation of taxes however makes this aim highly unlikely to achieve.

One of the widespread fallacies is that small enterprises grow by expansion in size. Evidence from research, both in Egypt, as well as in other developing countries suggest that only a minority of small businesses grow over time. Among this minority, an even smaller minority manages to graduate into higher enterprise size categories (i.e. medium or large).

Accordingly, obtaining long-term financing, sizeable loans, issuing bonds or even seeking additional partners is not a high likelihood for a prototypical small enterprise. For example, a recent research over a sample of more than 1,200 small and micro entrepreneurs shows that 75% of rural small and micro enterprises did not add workers over their lifetime. Most of those that did add workers added only a single worker. While urban small and micro businesses were more likely to add workers, the majority (65%) actually either witnessed no change or decreased the number of workers. The same pattern was also revealed when it comes to adding capital over their lifetime[10].

[10] Gavian, Sarah, Tamer El-Meehy and Lamia Bulbul, "The Importance of Agricultural Incomes to Small and Micro Enterprise Development and Rural Employment in Egypt", USAID-Cairo, Agricultural Policy Reform Project, August 2002.

Annex 1

Focus Groups List[11]

Focus Group # 1, Cairo, 29/06/2002

1. Garments Factory – North Giza, Ezbet Elmoufty, end of El Batrawy St.
2. Geometrical Models Workshop – El Sabteiya, Boulak
3. Embroidery Workshop – Roud El Farag District
4. Home-Based (cooking food then taking a fee) – Boulak Abo El Ella
5. Leather Factory – Imbaba district
6. Restaurant (Kababgy) – Ard El Lewaa district
7. Marble Factory – El Kitkat District

Focus Group # 2, Cairo, 03/07/2002

1. Restaurant – Khalafawy district
2. Leather Factory – Shubra, Roud El Farag, District
3. Wholesaler- Sharabia district
4. Food Packing – Roud El Farag District
5. Garments Factory – Zamalek district
6. Filters & Pipes Factory and Distributor, Giza district, El Bahr El Azam St.
7. Textiles – Wekalet El Balah, Boulak district

Focus Group # 3, Cairo, 04/07/2002

1. Aluminum and Glass Workshop – Bulak district
2. Maintaining and selling bicycles – Bulak district
3. Wholesaler – Khalafawy district
4. Batteries tools Workshop – El Sabteiya district
5. Embroidery and garments factory– Roud El Farag District
6. Selling Ice Cream – Roud El Farag district
7. Furniture workshop – Shubra District
8. Grocery – Roud El Farag district
9. Bakery - Roud El Farag district

[11] Names of entrepreneurs are withheld based on agreement with the attendants of the focus group sessions.

Focus Group # 4, Cairo, 07/07/2002

1. Mechanic – Roud El Farag District
2. Leather Workshop (Shoes) – El Saheil District
3. Wholesaler – Shubra District
4. Manufacturing Cheese – Shubra Misr District
5. Garments Shop – Boulak district
6. Manufacturing sweets – Shubra El Balad, El Saheil
7. Mechanic – El Azbakia
8. Metal casting – Boulak Abo El Alla District

Focus Group # 5, Cairo, 08/07/2002

1. Restaurant (Koushary) – Boulak district
2. Motor cycles maintenance - Wekaleit Elbalah district
3. Leather workshop – Shubramant district
4. Bakery and manufacturing sweets – El Khalafawy district
5. Car's Electrician - Sharabia district
6. Socket's Factory (Spinning) – Shubra El Saheil
7. Marble Factory – Torra district shaa El Te'aban
8. Glass and mirrors workshop – Manial District
9. Embroidery and Garments Factory – Hadayea El Maadi

Focus Group 6, Sharkia, 17/10/2002

1. Grocery a village includes Zagazig district.
2. Bucher – Zagazig district.
3. Manufacturing Glass & Mirrors – Zagazig district.
4. Bucher – Zagazig district.
5. Khan El Khaleily Products – Zagazig district.
6. Contractor – Zagazig district.
7. Women's Make Up - Zaqazeeq

Focus Group 7, Damietta, 4/11/2002

1. Leather Products
2. Furniture's Carpenter
3. Furniture Workshop
4. Furniture Polishing
5. Furniture Polishing
6. Furniture Workshop
7. Furniture Workshop
8. Furniture Workshop
9. Furniture Factory
10. Furniture Factory

11. Wood Workshop

Focus Group 8, Alexandria, 09/02/2003

1. Bakery
2. Car Electrician
3. Metal Casting Factory (Windows & Doors)
4. Frames, Glass & Mirrors Workshop