

# **ASSISTING FAMILY BUSINESS IN THE INFORMAL ECONOMY: A LOOK AT AN INNOVATIVE CREDIT PROGRAMME IN EGYPT LEO PAUL DANA**

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## **Abstract**

The nature of an enterprise reflects the economic sector in which it is operating and managerial alternatives can be constrained by external factors, such as the lack of credit. Using Egypt as a case study, this conference paper is based on field research involving ethnographic data collection. Formal firms, competing with one another in Egypt's free-market sector, were found to benefit from segmenting consumers, in order to better cater to a well-identified target market. In contrast, firms in the state-controlled planned sector report less of a concern with market segmentation. Most family-owned firms, in Egypt, operate in neither of the above. Instead, family businesses are concentrated in the informal bazaar economy. Here, segmentation refers not to consumers but rather to the clustering of producers. Instead of competing with one another, family firms often cooperate. Competition, in this context, refers to the tension between buyers and sellers who negotiate prices. The focus is on personal relations. While entrepreneurs, in some countries, dream of expanding their operations, research findings reveal that family-owned enterprises in Egypt opt not to formalize; the owner-managers prefer to operate in the informal bazaar-type economy. Given that this sector has traditionally suffered from a lack of access to financing, a special credit program has been initiated, providing funds to assist family businesses in the informal sector. Artisans, itinerant traders and home-based industries have been benefiting, and according to interviews at the National Bank for Development, there have been almost no defaults. Quite distinct from banking services offered to the informal sector, Egypt's small enterprise credit program may serve as a model for other countries.

## **INTRODUCTION**

It is widely accepted that entrepreneurship contributes to development, with a positive effect on society, creating employment, economic expansion, a larger tax base, and more consumer well-being. Indeed, a healthy entrepreneurship sector contributes greatly to the development of an economy. This is increasingly supported by research, and governments around the world have acknowledged this. Relevant literature exists about entrepreneurship in Albania (Dana, 1996a), Argentina (Dana, 1997a), Australia (Dana, 1988b; Holmes, 1988), Austria (Dana, 1992a), Canada (Dana, 1990b, 1996c), the Caribbean (Dana, 1993b), China (Fan, Chen and Kirby, 1996), Cuba (Dana, 1996e),

Cyprus (Dana, 1997d), France (Dana, 1994a; Pache, 1996), Ghana (Dana, 1992b), Great Britain (Gibb, 1986-7), Hong Kong (Dana, 1995b), Hungary (Hisrich and Fulop, 1995; Noar, 1985), Indonesia (Tamburan, 1992), Ireland (Walsh and Anderson, 1995), Japan (Morita and Oliga, 1991), Kazakhstan (Dana, 1997b), Kenya (Dana, 1993c), Laos (Dana, 1995e), Lesotho (Dana, 1997e), Malaysia (Dana, 1987), Moldova (Dana, 1997c), Mozambique (Dana, 1996d), Namibia (Dana, 1993a), New Zealand (Ghosh and Taylor, 1995), Nigeria (Anyansi-Archibong, 1987), Northern Ireland (Hisrich, 1988), Panama (Dana, 1995a), Papua-New Guinea (Ojuka-Onedo, 1996), Peru (Dana, 1988a), Scotland (Kinsey, 1987), Singapore (Dana, 1986-7), Slovakia (Ivy, 1996), South Korea (1990a), Spain (Dana, 1995d), Swaziland (Dana, 1993d), Sweden (Johannison, 1987), Taiwan (Dana, 1994-5), Togo (1992b), the United States (Dana, 1995c), Uruguay (Dana, 1997a), Venezuela (Dana, 1996b), Vietnam (Dana, 1994b), and even Yugoslavia (Dana, 1994c). This paper is the result of field research about small firms in Egypt.

Often, a model which has been successful, in the formal sector of the United States, is trans-located to another economy where it fails. Why does a model bring success to entrepreneurs in one environment and not to those of another?

Chamard and Christie (1996) focus on why existing entrepreneurship programs fail. Among the causal variables which they identify are: excessive regulation which curtails formal activity; financial constraints; and the confusion between formal entrepreneurship and informal activity.

Brockhaus observed that "the culture of Egypt is such that a very weak private enterprise system exists except in the informal sector (1991, p.81)." Indeed, Egypt is an example of a country in which regulations have discouraged entrepreneurs from entering the formal sector. Therefore, it is very important to distinguish, here, between formal entrepreneurship and informal family enterprise. The following definitions may be useful:

- The **Bazaar Economy Informal Sector** is a social and cultural system, a way of life and general mode of commercial activity such that most of the flow of commerce is fragmented into numerous disconnected transactions between individuals. The units of interest are the entrepreneur and his micro-enterprise. Family firms in this sector have traditionally suffered from financial constraints. Dana's (1992b) detailed discussion of the informal economy is presented concisely in Chamard and Christie (1996).
- The **Firm-Type Formal Sector** is an economic institution involving a mode of commercial activity such that industry and trade take place primarily within a set of impersonally-defined relationships. It is assumed here that transactions will occur such as to maximize benefits based on rational decision-making rather than on the nature of personal relationships of entrepreneurs.
- The **State-Controlled Planned Sector** is the result of government intervention in the national economy.

The above are illustrated in Figure 1.

The informal sector appears to be the most popular in Egypt, with 250,000 informal micro-manufacturing establishments, each having five employees or fewer; as well, there are several hundred thousand petty and itinerant traders. Given that these have traditionally had a lack of institutional credit, a small enterprise credit program has been implemented, and its success suggests that an attempt should be made to draw from its experience.

## **METHODOLOGY**

This essay is based on field research, using ethnographic methods. Data was collected using open-ended interviews, conducted in Arabic. Respondents were selected from: (i) the informal sector; (ii) firms in the formal sector; (iii) the state-controlled planned sector; and (iv) the government, governmental bodies and para-statal organizations. Especially helpful were: the Industrial Development Bank of Egypt, the National Bank for Development, the National Bank of Egypt, the National Investment Company of Cairo, the University of Cairo and the United States Agency for International Development (USAID).

## **HISTORICAL BACKGROUND**

Located at the junction of Africa and Asia, Egypt has long been a center for business. The ancient Egyptians were among the world's first great civilizations. Records indicate that these people were already trade-oriented in 5000 BC. The Egyptians were among the first nations in the world to learn to use metals. For thousands of years, men here have worked as metal-smiths, making jewelry, knives, swords and the like. Records, from about 1500 BC, list cargo boats on the Nile, and describe their freight with meticulous detail. Every nobleman of the time employed a staff of scribes, in charge of accounting. Each goat and pigeon, on an estate, was recorded. During the rule of Pharaoh Ramses II (circa 1240 BC), self-employed artisans in Egypt were making jewelry and small-scale industry included perfume manufacturing. Typical of the bazaar economy, prices were negotiated.

During the fourth century, the Church of Alexandria was established in Egypt. The descendants of its founders are known today as the Copts. In 639 AD, Islam arrived in Egypt; more than a religion, it became a way of life. Cairo was established as El Qahirah in 969 AD; it would become the capital of the Moslem Fatimid Empire. In 970 AD, the El Azhar Mosque was built, evolving into a university, and it has remained a prominent institution that preserves Islamic theology and philosophy.

Between 1517 and 1914, Egypt was under Ottoman rule. During that time, Egypt's best artisans and craftsmen were taken to the Ottoman capital, Istanbul, then known as Constantinople. Ottoman rule was temporarily interrupted when Napoleon occupied Egypt from 1798 to 1801. Then in 1805, Mehemet Ali, an Albanian soldier in the

Ottoman army, gained control of Egypt, and leased Egypt's semi-independence from the Ottomans. Under this arrangement, Egyptian leaders, known as *khedives*, paid a tax to the sultan in exchange for political power. One might best describe this as an early form of franchise. Egypt's last king, Farouk, was a descendant of Mehemet Ali.

In 1853, Egypt became the fifth country in the world, and the first one east of Europe, to establish a railway infrastructure. The following year, French diplomat Ferdinand de Lesseps proposed the construction of the Suez Canal, a 102 mile-long waterway across the isthmus of Suez, linking the Red Sea to the Mediterranean Sea. Since its opening in 1869, the Suez Canal greatly facilitated trade between Europe and the Far East. French became the language of business and of high society in Egypt, and English influence followed. In 1875, the British government bought control of the Suez Canal. After the declaration of World War I, Britain made Egypt a British Protectorate and deposed the khedive, Abbas Hilmi, who was accused of being pro-Ottoman. Abbas Hilmi's uncle, Hussein Kamil, replaced him. When Hussein Kamil died, he was succeeded by his brother Ahmed Fouad, later known as Sultan Ahmed Fouad Pasha. Egypt was declared an independent country on February 28, 1922, and on March 16th, Fouad was crowned King of Egypt. King Fouad was succeeded by his son, Farouk, in April 1936. Up to WWII, Egypt had the highest death rate in the world, and four out of five Egyptians had bilharzia, malaria or both.

## **ECONOMIC SECTORS IN EGYPT**

### **The State-Controlled Planned Sector**

Under the rule of King Farouk, Westerners lived very well in Egypt. Meanwhile, millions of *fallahin* (Egyptian peasants) were limited to subsistence-level farming on tiny plots of land, for which they paid high rents (Mostert, 1972). This prompted support for nationalism, and for centrally-planned state-controlled redistribution of land.

In January 1952, a battle broke out between British troops and Egyptian police in Ismailia, near the Suez Canal. The next day, Cairo witnessed violent anti-Western riots. On July 23rd, 1952, General Mohammed Naguib prompted a military coup. King Farouk abdicated and departed for Italy. A government decree limited land holdings to 200 fedans (about 200 acres). After the fall of the monarchy, the government of Egypt became the most important player in the national economy. In 1956, Colonel Gamal Abdel Nasser became president. His dream was to industrialize Egypt and for this he needed energy. A hydro-electric dam at Aswan could greatly increase power potential, but would cost a fortune to build. Nasser felt he could best accumulate capital by confiscating the revenues of the Suez Canal Company. After an armed conflict with Britain and France, Nasser proceeded with the Aswan Dam, a project which drowned all of the region called Egyptian Nubia. The Nubians are an ethnic minority of mixed Arab and Negro blood. Paying the price of progress, these people have been forced to leave

their villages with only necessities, leaving pets and belongings behind.

Massive urbanization created very densely populated cities. This results in consumers being clustered tightly, in theory facilitating the logistics of distribution. However, this is counter-acted by the fact that the cities are crowded and traffic is slow. As one problem led to another, the state centralized control through its bureaucracy, thus intervening in various industries. During the socialist era of the 1960s, the design of the public sector projects was based on the manufacturing of final products, as well as of intermediary goods. This resulted in a monopolistic environment arising from large-scale factories upon which the economy became dependent. Although government sub-contracting provided opportunities for entrepreneurs, nepotism was very common.

In the absence of true competition, production costs increased as quality declined. The loaf of bread is a good example. Egypt grows only half of its wheat needs. With \$750 million in subsidies from the United States, Egypt has been importing wheat, which is processed at state-owned flour mills. These provide 80 percent of the nation's whole-grain flour. The subsidized flour is distributed to thousands of local bakers, who use coal ovens to make traditional round loaves with hollow pockets. All of the consumers surveyed by the author report that the average size of a loaf of bread has been shrinking each year. Another change occurred in December 1996, when the government began substituting flour made from wheat, with a blend of corn. Small-scale bakers have been expressing concern because bread containing corn puffs differently. Depending on the flour used, taste also varies. Furthermore, bread made from corn flour gets stale faster. In recent years, the government stopped subsidizing rice, soap and tea. The relaxation of some regulations has permitted competition in some industries. However, the need for economies of scale has served as a barrier to entry, barring out small-scale entrepreneurs. The role of government has been gradually shifting from that of controller to that of facilitator. For instance, one autonomous governmental agency, which has been particularly interested in generating sustainable development among small business, is the Social Fund for Development, which is under the direction of the prime minister. The agency attempts to promote innovative (high value added) products and services, for international as well as for domestic markets. Specifically, the Social Fund for Development is interested in:

- developing the awareness that such industries are important;
- encouraging youth to become entrepreneurs;
- supporting the expansion of existing small firms;
- encouraging new venture creation;
- decentralizing development with agricultural development; and
- linking small enterprises with larger ones.

## The Firm-Type Formal Sector

Up to the 1950s, Greeks, Italians and Jews prospered as prominent entrepreneurs in Egypt, while much larger business was controlled by Belgian, British and French interests. Downtown Cairo was largely inhabited by Europeans, including Britishers, Frenchmen, Greeks, Italians and Jews, many of whom were entrepreneurs in the formal sector of the economy. These created for themselves a European-style firm-type formal sector, with a focus on impersonal transactions. The market was segmented such as to identify niches and cater to particular target markets. Competition took place among a large number of firms. Prices were tagged, reflecting market forces. The subsequent rise of Arab nationalism and the exile of King Farouk, however, resulted in an exodus of formal entrepreneurs.

During the past several decades, there has been a decline of enterprise culture in Egypt. Prevailing social values accord higher recognition to university education than to commerce; yet, universities do not teach entrepreneurship here. Public sector jobs in Egypt are more prestigious than mercantile or industrial careers.

Among the many obstacles to the establishment of a formal firm in Egypt is government bureaucracy with its paperwork requirements. There are over fifteen long and difficult procedures to be taken care of, distributed over a complex variety of government officials, some of whom expect bribes. The firm-type formal sector is nonetheless impressive. Ninety percent of the ten thousand formal enterprises in Egypt have fifty or fewer employees, and as such are considered to be small businesses. These small firms tend to be labor-intensive. During the early 1990s, growth in exports among small enterprises in Egypt averaged 3 percent, compared with 1 percent for large firms.

It should be mentioned that it is not common, nor socially acceptable, for women in Egypt to engage in enterprise. Nor is it common to allow new entrants into oligopolistic markets. Therefore, a rigid system of corruption requires substantial bribery in order for formal new ventures to be launched. The least formal enterprises within the firm-type formal sector are small industries. These include declared artisans. Whereas large-scale enterprises usually have a high level of capital investment and are often managed by professionals, small industries are normally owned and operated by an entrepreneur and/or a family. In the case of small industries in Egypt, fixed assets and technological inputs are limited, as is access to formal financing; nevertheless, hired labor is common.

Artisanal enterprises are less structured and artisans are less likely to have employees who are not related, either by blood or through marriage. Often, the craft is carried out along a pavement or in a private residence. In 1976, Decree 217 officially defined the artisanal sub-sector as involving an individual who labors in a given apprentice, with no more than nine employees. Wages are low, but workers are often enthusiastic, especially when an establishment becomes a training center for unskilled labor. The decree recognizes the use of some tools as legitimate, but specifies that the artisan relies primarily on manual effort. Equipment is limited to inexpensive and usually old, traditional tools rather than machinery.

## The Bazaar Economy Informal Sector

The typical consumer in Egypt is traditional in that superstition is very important in daily life. An external locus of control is commonplace. Rather than speaking assertively, with certainty, it is more socially acceptable to say "*Ensha'Allah*," meaning that things will happen if God wants them to. Credit is also given to God with the frequently heard praise "*Hamdel'Allah*." Arousing jealousy is shunned, as consumers believe it can lead to "*el ein*," the evil eye. Therefore, garlic, the color blue, the number five and the *khamissa*- an object in the shape of a hand - are all used to protect oneself from such bad luck. Before going to sleep, rather than saying "Good night," one says instead, "*Tesbakh-alla-kher*," meaning "May you awaken to goodness."

All these cultural values have helped a very ancient bazaar economy survive in Egypt to this day. Much activity flourishes here, because central to the bazaar economy is personal (as opposed to impersonal) activity. Most small businesses in Egypt today fall in this category. Business activity is fragmented into numerous transactions between individuals, who tend to have a personal relationship.

Central to the national economy of Egypt is the *fallah* (plural: *fallahin*) working the land, much as was done millennia ago. Ninety percent of Egypt is covered by desert, and rain is sparse; the *fallah* irrigates his land by a water wheel known as a *sakiah*, which is powered by a *gamoussah* - a beast of burden similar to the water buffalo. This animal is also used to plow fields and to thresh wheat. As well, milk is obtained from it. Due to the lack of pasture-land, caused by the annual flooding of the Nile, it is not conducive to keep cattle.

Much more common than cattle, are camels, which contributed greatly to business development in Egypt - and which are still used to this day. Known as ships of the desert, camels can cover long distances at speeds of 20 kilometers per hour. When loaded with some 200 kilograms, they slow down to four to five kilometers per hour. Camels are ideal for desert travel, as their water reserves can reach 35 liters. Thus, it is never necessary for them to drink more than once every two weeks—even during the summer. Sexual maturity is attained between the age of three and four years old, and a camel can easily live thirty years.

In contrast to the batrian camel which has two humps, and which is found in central Asia, the dromedary, native to North Africa and Arabia has only one hump. The hump swells during the rainy season and stores fat. Usually, camels are vegetarian. However, when very hungry they will eat the skin and bones of other animals and of fish. Although this unaffectionate animal has a bitter disposition and a temper, it is sturdy, strong and does its job well. Not only are camels used for trading, but they are also traded. Today, at a large camel market, near Cairo, camels are still bought and sold, much as they were centuries ago.

In contrast to the firm-type formal sector, where segmentation refers to the market, in

the bazaar economy informal sector both production and retailers are segmented. Farmers are clustered geographically, as are artisans, tradesmen and shepherds. Many market transactions take place in the streets where there is a constant bustle and movement of crowds as one ambles along. As well, in contrast to the firm-type formal sector, where competition takes place between sellers, competition in the informal market implies a tension between buyer and seller, rather than among sellers. The lack of information results in a very imperfect market, and with few exceptions, such as basic food staples, retail prices are not indicated; rather, these are determined by negotiations. The customer first tests price levels informally, and only later begins to bargain. Vendors are often less likely to maintain high prices during the early afternoon, as the effect of heat and of hashish can diminish one's energy. Price, therefore, is a function of a variety of factors, including cost, apparent value, time, negotiation skills and circumstances. Once a mutually satisfactory transaction has taken place, it is desirable to establish a long-term relationship. This makes future purchases more pleasurable and efficient, as less time is spent negotiating, and more can be allocated to drinking tea, for instance.

When examining the social structure of the bazaar economy, the relations among the players within it, their organization and their economic principles, it is useful to consider the power structure involved. Traditionally, the leader of an Islamic community exercises three political powers: executive, legislative and judiciary. In addition, he is considered to be a religious leader.

The early *khalifes*, including Omar, Othman and Ali, were considered to be successors to Mohammed, prophet of God. They were regents, judges, military chiefs and religious leaders all in one. According to Ibn Khaldoun, the political and religious leader has the responsibility to protect the religion as well as the direction of the people. Interestingly, such principles survived into the 20<sup>th</sup> century.

Tradition dictates that Moslems should pray five times a day: before sunrise, at noon, during the mid-afternoon, at sunset and at dusk. Although modern Egyptians are often secular, they are called to pray from minarets which serve as public address systems. This custom stems from Bilal, Mohammed's companion, who called followers to prayer in Medina.

In Islamic society, the leader of religious services is known as the *imam*. Facing Mecca, he must bow and recite the words of prayer, as an example to others. In contrast to the Shiites, who consider their imams to be actual descendants of Ali, the Moslems in Egypt are mostly Sunni. A reminder, of the early days of Islam, is the privileged social status accorded to self-employed merchants and artisans. This is not surprising, given the environment in which Islam developed. Even Mohammed was personally impressed by the camel caravan voyages of traders.

Although the guilds of the bazaar economy never had a power equivalent to those of Western Europe, fees were collected from guild members and funds were accumulated. Some of this money was used to grant loans to new enterprises. Hierarchy within these organizations was less structured than in their occidental counterparts. An apprentice

in Western Europe was dependent on his master and subordinate to him - he was therefore expected to be submissive to the master. In the bazaar economy, in contrast, the greatest difference between a master and an apprentice is simply professional qualification.

The informal sector in Egypt provides several important social functions. It allows the creation of jobs with limited capital; it provides employment for every level of skill; it enables apprentices to learn on the job; it permits development with limited technology; it diffuses income; and it allows the cherished family unit to work together. This sector produces 30 percent of Egypt's GNP. While the Industrial Development Bank of Egypt, the National Bank for Development and the National Bank of Egypt have recently supported the expansion of small firms in Egypt, it is considered normal for operators of informal enterprises to prefer to keep their business small and informal, rather than enter the formal sector. Egyptian government authorities are concerned about this general resistance to formalize, as informality is usually correlated with the lack of marketing skills. Furthermore, the informal sector also suffers from the lack of technology transfer as well as the lack of institutional credit.

### **SMALL ENTERPRISE CREDIT PROGRAM**

Although a bank in Egypt will close briefly five times a day for prayer, it may otherwise remain open all day and all night. However, all the bankers surveyed by the author, indicated that Egyptian banks have traditionally shared a negative perception of small business. Therefore, entrepreneurial families requesting loans are asked for considerable collateral and guarantees, and until recently, few small firms succeeded in obtaining formal capital. Yet, the informal sector in Egypt employs more direct labor per unit of capital than do larger firms of the formal sector. As well, informal enterprises in Egypt make due with unskilled, and at best semi-skilled, labor under the guidance of a skilled entrepreneur. Small firms in Egypt have a comparative advantage with their high labor-to-capital ratio. This is what led to the creation of the Small Enterprise Credit Program (SECP), a plan to assist informal entrepreneurs in the bazaar economy - individuals who have no collateral, no traditional security, no salary and no experience with banks. These individuals do not even have a license, registration or a work shop permit.

The SECP provides loans to artisans, to family firms and to other participants in the bazaar economy informal sector, on the basis of their ability to service the loan. Loans vary in amount from £E250 (Egyptian pounds) - under \$100US - to £E100,000. Unpublished data provided by the SECP branches indicate that the average loan is about £E2,000, with an average term of five months. The credit fund is reported to turn 2.4 times annually. Borrowers are selected based on their cash flow. Artisans, itinerant traders and home-based industries are amongst the 155 different informal activities financed by the SECP. According to interviews at the National Bank for Development, there have been almost no defaults.

Records indicate that 90 percent of the borrowers are male. This is not surprising as Egyptian culture does not support entrepreneurship among women. Nonetheless, counter to cultural values, funds are available specifically for female entrepreneurs in Egypt. The Canadian International Development Agency (CIDA) and UNICEF have formed partnerships with the National Bank for Development to manage special credit programs geared to women living in Upper Egypt, in Luxor and in Qena in particular.

Perhaps the success of the SECP experiment in Egypt, can serve as an example to other nations as well. Future research should inquire into the long-term effects of a SECP experiment. Also, its replication elsewhere might prompt future research into cross-cultural applicability of such a program. Studies could compare the nature of loans, the type of borrowers and the probability of success and the long-term impact on small business.

## CONCLUSION

The Egyptian economy presents three important environments for business: the state-controlled planned sector; the firm-type formal sector; and the bazaar economy informal sector. The role of the entrepreneur varies greatly depending on the environment in which he or she is operating. Small-scale family-owned enterprises are important movers of economic growth in Egypt, and firms in this sector are central to the economy despite the traditional lack of government support. Only recently has attention been given to the informal sector through the SECP experiment. As a result of the initial implementation, it would appear that this plan is providing measurable results in contributing to economic development within Egypt's bazaar economy.

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**FIGURE 1**  
**ECONOMIC SECTORS IN EGYPT**

