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# Egypt Enterprise Sector Problems: The Case of Iron & Steel Co (1)

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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 third[1].

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 China[2].

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 $2.5[3].

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

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[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 President[4].

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 Industries[5].

## 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

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[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 projects[6].

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 he 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 thefts[7].

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 budget[8].

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 interest[9].

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=y.

- 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 them[10].

## 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 |

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

[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.

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 Iron and Steel 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 before it was liquidated, namely: the Iron and Steel Company:

The Iron and Steel Company is one of the oldest Egyptian public sector companies, and the first iron and steel company in the Middle East. It was established in 1954 in Al-Tebbin area, Helwan, Cairo, during the era of former President Gamal Abdel Nasser on an area of 1,700 feddans (acres). The company started production in 1961 with a plan aimed at producing 1.2 million tons as an annual capacity, where it became the first integrated complex for iron and steel production in the Arab world with a product that conforms to international standards, with a capital of EGP 21 million[11].

The Iron and Steel Company is the first of its kind working in the field of extracting iron ore and manufacturing iron and steel in Egypt using blast furnace technology. The company produces iron and steel products, shaped, half-formed and raw, such as iron sectors, hot flats, cold flats, billets,

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[11] After 67 years.. liquidation of the Iron and Steel Company in Egypt. Al Jazeera, 31 May 2021. https://mubasher.aljazeera.net/news/2021/5/31/67-year-after-liquidation-of-iron-and-steel-in.

and base cast iron. The Metallurgical Industries Holding Co owned 94% of the company's shares, while the National Investment Bank owned 2%, and the remaining percentage was traded on the stock exchange[12].

The iron and steel plant has always worked for the benefit of the Egyptian state and the Egyptian army, and played a major role in rebuilding the Egyptian army after the 1967 defeat, as it was an essential element in the manufacture of missiles to protect Egypt from Israeli raids, and greatly contributed to the construction of the High Dam. The plant's products were included in many major industries such as the manufacture of cars, railway wagons and ships, thus the iron and steel industry deserved the title of the Egyptian Industry Castle.

In January 2021, a decision was made by the company's extraordinary General Assembly to divide the company into two companies: the Iron and Steel Company, and the Mines and Quarries Company, and later a decision was issued to liquidate the Iron and Steel Company.

The irony here is that the Mines and Quarries Company was established with a capital of EGP 195 million, and this low value is the book value of the company since the inception of the Iron and Steel Company, which is considered a deliberate waste of the value of the company and a major financial corruption, as the book value, not the actual current market value, was calculated, given that the company owns billions of Egyptian pounds worth of gold mines, in addition to owning huge quarries and lands that are not available to any other public and private industrial sector company[13].

In May 2021, a decision was made by the company's general assembly supporting the liquidation of the Iron and Steel Company, 67 years after its establishment, claiming low financial and production performance and inability to commit to provision of the wages of employees and repayment of debts.

Here is some of the company’s financial indicators to clarify its financial position and identify the problems that the company had faced before liquidation: (value in EGP 1000)

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[12] The official website of the Egyptian Ministry of Public Business Sector. http://www.mpbs.gov.eg/Arabic/Affiliates/AffiliateCompanies/Pages/AffiliateCompaniesDetails.aspx?id=12.

[13] Ahmed Saqr Ashour, Troubled and absent governance in public sector companies (the Case of the Iron and Steel Company), Watan Portal, 3 Jan 2021. https://www.elwatannews.com/news/details/5345054

| Statement | 2016/2017 | 2017/2018 | 2018/2019 |
|---|---|---|---|
| Net activity revenue | 1619861 | 1617604 | 1242820 |
| Net profit | -750260 | -899606 | -1586885 |
| Exports | 291000 | 158447 | 8152 |
| Wages | 751894 | 757105 | 843788 |
| No. of employees | 8685 | 8027 | 7502 |

*Source: Public Enterprise Sector Ministry*

It is evident from the above table that the net revenue of the Iron and Steel Company continued to decline during the period (2016-2019), amounting to about EGP 1.6 billion in the fiscal year (2016/2017) and reaching about EGP 1.2 billion in the fiscal year (2018/2019).

It indicates that the company's losses increased in the same period from about EGP 750 million in (2016/2017) to about EGP 899 million in (2017/2018) ) and then to about EGP 1.5 billion in (2018/2019).

There were conflicting statements by officials about the value of the company's loss in the fiscal year (2019/2020), but the Iron and Steel Company announced the outcome of the board of directors meeting, that approved the company's financial position, declaring that the company achieved losses for the year (2019/2020) amounting to about EGP 982.8 million[14].

The largest exports were in (2016/2017), where they amounted to EGP 291 million, and declined to EGP 158.1 million in (2017/2018), with a decrease of 45.6%, and then declined to EGP 8.1 million in (2018/2019), with a decrease of 94.8 %.

The Export Council of Building Materials, Refractories and Metal Industries announced that the Iron and Steel Company's exports during the period (January 2020 to December 2020) fell to EGP 11.513 million, compared to EGP 11.722 million during the same period in 2019, which may be explained by the decline in global demand for iron after the COVID-19 crisis.

[14] Hani Al Houti. Iron and Steel Company incurred losses of 982 million pounds in a year, down 1.55%, Youm7, 21 Oct 2020. https://www.youm7.com/story/2020/10/21/Iron-and-Steel-company-incurs-losses-982-million-pound-within-a-year/5030497.

The decline in iron and steel exports can be explained by the increase in iron prices as a result of the high cost of iron production in Egypt, while prices declined globally, therefore, it did not withstand price competition in the international trade market. The Central Bank of Egypt's decision to float the Egyptian pound has also caused a rise in the prices of imported raw materials used In the production process and had an impact on the high cost of iron production in Egypt.

The Director of the Chamber of Metallurgical Industries explained that one of the reasons for the decline in iron prices globally was the low prices of energy supplied to companies (petroleum - coal - gas - electricity), which reached about $1.5 per million thermal units of gas, while in Egypt they reached up to 4.5 dollars per million calories[15].

The iron and steel industry in Egypt faces the challenges of dumping and unfair competition with imported iron, especially from Turkey, China and Ukraine, at prices lower than the production cost. Thus, the marketing share of the local product eroded in favor of the imported product, which leads to huge losses in the local iron and steel industry[16].

After the decision to liquidate the Egyptian Iron and Steel Company, controversy increased on whether such decision was to achieve the national industry's interest or to achieve personal interests?

The company's General Assembly justified the decision to liquidate the company by its high losses and inability to operate again, while the Ministry of Public Enterprise Sector issued a statement stating that the reason behind the company losses was the obsolescence of the technology used, and the low concentration of iron extracted from the company's mines in the Wahat area, not exceeding 50% on average, which contributed to increasing consumption of coke and gas in the production process and inflating direct costs, while the required concentration for economic production is within the range of 60%.

He added that the poor condition of the furnaces and the frequent stops of the fourth furnace, which reached 92%, contributed to the high energy consumption, as the energy elements share of a ton of

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[15] Abdullah Abdo, Egyptian iron exports fell by 37%... and 60% of the factories' capacity were idle, The New Arab, 21 August 2020. https://www.alaraby.co.uk/Egypt-Iron-Exports-37-and-60-from-Energy-%E2%80%8Ffactories-is-idled.
[16] Heba Abdel Dayem, Manar Shaaban. Iron and Steel Industry, Sectoral Studies Series. National Investment Bank, 2017. http://www.nib.gov.eg/PDF/sectors_reports/005_Hadid Final.pdf.

iron and steel produced reached 44.3 million British thermal units, compared to 20.6 British thermal units per ton in competing plants, in addition to Coke, where the share of a ton of Coke in the company is 1,300 kilos, compared to a global average of 300-600 kilos per ton consumption. It is to be mentioned that the Tata Steel Co. conducted a study to develop a plan for saving the Iron and Steel Company, and issued a report in which it indicated the need to develop old equipment and replace the dilapidated equipment, repair and maintain railways for transporting iron ore to the plant, and the need to operate the kilns at maximum power for a period of 3 continuous months, which did not happen, as the kilns were operated with a capacity of 12 operating hours for only 15 days[17].

However, on the ground, this report had not been even studied, as the furnaces have not been modernized since they entered service in the sixties and seventies, which led to a decrease in their productivity, and severe damage due to poor operation, where the equipment used by the company was not maintained until it was worn out. Also, the supplies of coke needed to operate the furnaces decreased, therefore, there was a deliberate negligence by the successive departments of the company that eventually led to incurring the company huge losses, whether in the company's assets of equipment and furnaces or in the company's products and quality.

To refute some circulated reports that one of the reasons behind the losses incurred by the Iron and Steel Company was the rise in wages, which accumulated large financial burdens on the company, with a need to lay off a large percentage of workers to reduce such burdens, the following can be stated.

The above table shows the company's number of employees and their total wages. We note the continued decline in the number of the company's employees, where the number of employees was about 8685 workers in the fiscal year (2016/2017), but decreased to 8,027 workers in (2017/2018), then it declined again to 7,502 workers in (2018/2019); and the total wages in (2016/2017) were about EGP 751.8 million, which rose to EGP 757.1 million, and then up to EGP 843.7 million.

[17] The public enterprise sector reviews the profits and losses of the Iron and Steel Company: workers' rights are protected. al Watan,. 17 Jan. 2021. https://www.elwatannews.com/news/details/5232822.

Calculating the average wage of a worker per year, we find that during the fiscal year (2016/2017) it was about EGP 86 thousand, in the year (2017/2018) it was about EGP 94 thousand, and in (2018/2019) it amounted to about EGP 112,000.

Comparing the average wage of a worker in the Iron and Steel Co with the average wage of a worker in other public sector companies, we find that the average wage of a worker in the Iron and Steel Co is lower, as according to the data announced by the Central Agency for Public Mobilization and Statistics (CAPMAS), the average wage of a worker in public sector companies in FY (2016/2017) was about EGP 106 thousand, and in (2017/2018) amounted to about EGP 122 thousand.

In addition, when the company was established, the number of employees was much more than it was before it was liquidated, and yet the company used to achieve high profits, which refutes any misleading rumors in this regard. In fact, the company's financial burdens increased due to corruption, and managers' focus on collecting material gains at the expense of the company’s interest, in addition to the spread of bribery in a blunt way.

It is worth noting that after making the decision to liquidate the Iron and Steel Company and the workers' demands for receiving their material entitlements, the company is looking for obtaining a bank loan to pay compensation to workers, as the Ministry of Public Enterprise Sector offered, ranging between EGP 225 and 450 thousand for each worker, while the union federation demanded compensation between 400 EGP and 700 thousand for a worker. What if such funds were spent on maintaining and renewing the factory’s worn-out machinery and equipment, which was one of the reasons for its losses? And what if they were spent on paying off part of the company's debt to the plant’s creditors?

It can be said here that the decision to liquidate the Iron and Steel Co was to achieve personal interests, both for the benefit of the private iron and steel companies, specifically the Ezz Steel Company that acquires 50% of the total volume of iron production in Egypt, according to a study of the National Investment Bank in 2017[18], or for the benefit of foreign investors who benefit from the liquidation of the company and the scrapping of its assets of land and equipment.

Private iron and steel companies have an interest in monopolizing the market entirely to facilitate their manipulation of market prices and control of iron supply in Egypt. However, foreign investors benefit from the difference in the price of the company's assets sold after liquidation, as the company owns an area of land estimated at 6 million square meters, in addition to machinery and equipment in the plant[19].

Whoever benefits from the liquidation decision, Egypt has lost one of its industrial fortresses, and a huge strategic industry that was behind achievement of Egypt's industrial renaissance one day.

## 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 Iron and Steel company as a case study and an applied example of Egypt's public enterprise sector companies, where it has become clear that the

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[18] Heba Abdel Dayem, Manar Shaaban. Iron and steel industry. Sectoral Studies Series, National Investment Bank, 4, 2017. http://www.nib.gov.eg/PDF/sectors_reports/005_iron final.pdf.

[19] In preparation for sale... division of about 1,400 acres of Egyptian Iron and Steel lands, Al Jazeera, 22 June 2021. https://mubasher.aljazeera.net/news/economy/2021/6/22/Taksim-6-million-square-meter-of-iron-lands.

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 decision to liquidate the Iron and Steel Co was only to achieve personal interests, whether in favor of private iron and steel companies or in favor of foreign investors, given the fact that the ministry received many offers to save the company from the losses it had suffered, but unfortunately, the ministry was delaying implementation for unknown reasons until the company was sold under the yoke of losses.