4. Egyptian Case Studies

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INTRODUCTION

This chapter presents three cases of recent foreign investment in Egypt. In the case of the Egyptian Company for Mobile Services (MobiNil), an international consortium takes over a state-run mobile phone service, and modernises its operations in a rapidly growing and transforming market. The local partner subsequently becomes a regional player in Africa and the Middle East. Glaxo Smith Kline, a leading pharmaceutical firm, expands in Egypt through multiple acquisitions, while the parent firm itself is subject to M&A at a global level. The leading-brand ketchup manufacturer Heinz has established a production facility for the Middle East jointly with a Kuwaiti multinational specialising in being the local partner for foreign fast-food chains throughout the Arab countries.

THE EGYPTIAN COMPANY FOR MOBILE SERVICES (MOBINIL)

Introduction

Mobile telephony is capturing an increasing share of global telecommunications services, accounting for 23 per cent of global telecommunications revenues (up from 3 per cent in 1990). Mobile telephony is one of the high growth market segments of the Egyptian telecommunications sector, having outpaced the growth of fixed-line telephony, which currently stands at 7.5 million lines, growing at a compound annual growth rate (CAGR) of approximately 14.6 per cent during the period 1995/2000, compared with the staggering CAGR of 169 per cent for mobile telephony during the period 1997/2002 (American Chamber of Commerce in Egypt 2001, p. 14). Since the opening up of the sector to private investment in 1998, the Egyptian mobile telecommunications sector has been host to two of the world's largest mobile operators, namely France Telecom and Vodafone. The two companies, in partnership with their

Egyptian counterparts, have been operating as a duopoly, in what is perceived to be a market of remarkable growth potential relative to Africa and the rest of the Middle East region. Egypt has the third-largest number of mobile subscribers in the region, outnumbered only by South Africa and Morocco. Penetration rates, which currently stand at 5.4 per cent of the population, are forecast to reach 15.5 per cent by 2008 (American Chamber of Commerce in Egypt 2001).

This case study explores FDI in the mobile telecommunications sector in Egypt, by throwing light on the first private operator, namely the Egyptian Company for Mobile Services (ECMS), known in the Egyptian market by the brand name ‘MobiNil’.

The Industry

The global wireless communications market has undergone remarkable growth since its initial years of operation during the late 1980s. The most widely used system for mobile communications networks is the Global System for Mobiles (GSM), which is used by roughly 62 per cent of global mobile telephony. In the Middle East region, more than 90 per cent of mobile telecommunications is dependent on GSM 900 networks (American Chamber of Commerce in Egypt 2001,p. 6). The Middle East region accounts for a relatively small share, 2.7 per cent, of the world GSM market. By 2006, the world GSM industry is forecast to service 1.4 billion subscribers, of which the Middle East region is expected to retain a relatively unchanged share of 2.8 per cent (www.gsmworld.com). In the global telecommunications market, three sectors are expected to lead future growth: wireless, data and, to a lesser extent, fixed-line telephony.

Compared to other emerging markets, the Egyptian mobile telephony sector was liberalised early, which allowed the private sector to invest in mobile communication networks, while line telephony to date remains a government monopoly. During the period 1998/2001, the Egyptian mobile telephony market has experienced high growth in terms of the number of subscribers, outpacing world growth rates as well as those in other Middle East and North Africa (MENA) countries. The liberalised status of the mobile sector in Egypt (Table 4.1) combined with its high growth potential, explains why the sector has become one of the FDI magnets.

The Investor

ECMS is an Egyptian Joint Stock Company, established under the Investment Incentives and Guarantees Law No. 8 of 1997, which grants a five-year tax holiday for ECMS. The purpose of the company is to establish, manage, operate, develop and maintain a digital cellular mobile telecommunication system (GSM) in Egypt. The authorised capital of ECMS is 1.5 billion Egyptian pounds (LE), and the Issued & Fully Paid-up Capital is LE 1 billion (100 million shares at LE10/share).

The three strategic partners in ECMS (France Telecom, Orascom Telecom and Motorola) formed the MobiNil Telecom consortium, which held a 51 per cent stake in the newly formed company. Orascom Telecom acquired 14 per cent of ECMS's shares on the stock market, 2 per cent are held by employees, and the remaining 33 per cent by small private investors. In 2001, the MobiNil Telecom consortium underwent a structural shift in terms of ownership, following the exit of Motorola. When the company was established in 1998, the MobiNil Telecom shares were divided between France Telecom (41.6 per cent), Motorola (35.3 per cent) and Orascom Telecom (18.6 per cent). In January 2001, Motorola sold its shares to both France Telecom and Orascom Telecom. Exiting the MobiNil consortium was a strategic decision, to secure Motorola's focus on the market for telecommunications equipment. From the business perspective of Motorola, maintaining market presence as a supplier for telecommunications equipment conflicted with its role as equipment supplier to (potential) competing GSM networks. Motorola's exit led to an increase of the shares of the two remaining MobiNil consortium members.

France Telecom

France Telecom is the majority shareholder, holding 71 per cent of MobiNil Telecom, and indirectly 36.3 per cent of the ECMS. It is one of the world's leading telecommunication carriers, present in more than 220 countries and territories, serving 90.5 million customers, with total sales revenue in excess of US$ 26 billion (http://www.MobiNil.com). It either operates under its own name or under the associated brands of Orange, Wanadoo, Equant, or other subsidiaries.

The rapid expansion of France Telecom through acquisitions outside of France as well as outside the European markets came as a reaction to the opening of competition in the French market, and the subsequent pressure on market shares. France Telecom generated three-quarters of its sales by operating as a monopoly in France. In 2002, more than 60 per cent of sales derived from its international operations. The France Telecom Group provides a range of services including: wireless communications, fixed line telephony, Internet access and cable networks. It has become the second-largest wireless operator and the number three Internet access provider in Europe, as well as a world leader in the provision of telecommunications solutions for multinational companies (http://www.francetelecom.com). It is expected that France Telecom will transfer its shareholding in the MobiNil Telecom consortium to the Orange Group, which is the GSM arm of France Telecom.

Table 4.1 Overview of telecom regulation of fixed data services (2002)

Incumbent	**Algeria** Algeria Telecom	**Egypt** Telecom Egypt	**Jordan** Jordan Telecom	**Morocco** Maroc Telecom	**UAE** Etisalat
Liberalisation status					
Mobile telephony	Yes	Yes	Yes	Yes	No
Fixed telephony	No	No	No	No	No
Leased lines	No	No	No	No	No
Data	No	No	Competition permitted	Competition permitted	No
ISP	Competition permitted	Competition permitted	Competition permitted	Competition permitted	No
Fixed satellite services	No	No	No	No	No
VSAT	No	Competition permitted	No	Competition permitted	No
No. of mobile operators	2	2	2	2	1
No. of ISPs (2001)	4	38	8	10-24	1

Source: World Bank (2002)

Orascom Telecom

Orascom Telecom is part of the Orascom Group of companies, which is one of the largest private sector conglomerates in Egypt, operating in the fields of telecommunications, construction and tourist development. It is one of Egypt's information technology leaders, and has become one of the largest GSM network operators in the Middle East, Africa, and Indian sub-continent, with some twenty-one licenses covering the region. Orascom Telecom has established leadership as a conglomerate in emerging markets. By September 2001, it had more than 3.5 million mobile subscribers in 20 countries (www.orascomtelecom.com).

Through acquisitions and tenders, Orascom Telecom has built a regional cellular telephone business, and apart from its 31.3 per cent stake in ECMS, it has stakes in the following companies (EFG-Hermes, April, 2000):

- Fastlink (65 per cent), the first Jordanian cellular phone company
- Telecel (80 per cent), a pan-African company with 11 cellular licenses in Africa
- Liberties (65 per cent), operator of the GSM network in Congo Brazzaville
- Chad GSM (80 per cent), operator of the GSM network in Chad.

Orascom Telecom has gained a reputation for GSM operations in emerging markets. Its latest greenfield addition was in Tunisia, where it has been awarded the license to build and operate a GSM network.

Compared with France Telecom's subscriber base of 90.5 million, Orascom Telecom's 3.5 million subscribers may seem modest. However, Orascom Telecom was a new entrant to the wireless communications business prior to acquiring stakes in ECMS. Subsequently however, Orascom has participated in several mobile phone consortia in Northern Africa and Arab countries. In less than four years it has developed a reputation as 'the' GSM network operator of the MENA region, and has extended its business to Asia with an 89 per cent stake in Mobilink, Pakistan's GSM operator. In 2003, Orascom led the consortium that received the first mobile phone license for the Baghdad region in Iraq.

While GSM wireless services account for the largest share of Orascom Telecom operations, its businesses also include a host of technology related activities in the domain of sales, support and services for computer hardware, software, networking equipment, test and measurement equipment, analytical instruments, security systems, and telecommunications products. It is also the distributor for information technology industry leaders such as Hewlett-Packard, American Power Conversion, Microsoft, Oracle, Novell, Netscape, and Lucent Technologies. Orascom Telecom acts as a holding company, with a number of affiliates and subsidiaries. These include Egypt's leading Internet service provider, a software developer/distributor, a computer superstore retail chain, and a stake in a national public pay-phone service provider. As of January 2002, the workforce of Orascom Telecom and its

GSM subsidiaries reached over 6,750 employees (www.orascomtelecom.com).

Local Acquired Firm

Wireless communications services are fairly recent to Egypt. Egyptian Telecom, the government owned telecommunications company, established the first GSM 900 network in 1996, and was responsible for network management. A French operator maintained the technical sides of operations. Together with Telecom Egypt employees, four public sector banks and two social insurance funds held stakes in Egypt's first GSM network. The network was run as a state monopoly up to May 1998, when it was acquired by the consortium led by France Telecom. In May 2001, the Telecommunications Regulatory Authority (TRA) agreed that Telecom Egypt should offer and operate the third GSM network after the exclusivity period granted to MobiNil and Vodafone expires. Telecom Egypt will operate a General Packet Radio Services (GPRS) network (American Chamber of Commerce in Egypt 2002, p. 44).

Entry into Egypt

The decision of the strategic partners of ECMS to acquire the first GSM network in Egypt was based on two key considerations. Firstly, ECMS operated as a monopoly over the four-month period between gaining the 'key' to the acquired company on May 21st, 1998, and entry of the second GSM provider in November 1998. Being the first private company to enter the market, taking over a subscriber's list of 80,000, as well as a 6-month waiting list, implied that ECMS's growth potential was substantial. The latest figures provided by ECMS indicate that between market entry in May 1998 and the fourth quarter of 2001, the number of subscribers increased from 80,000 to reach 2 million. The growth performance of ECMS has been impressive by world standards. While global wireless communications has been growing at 12 per cent, between 1998 and 2001 the average annual growth rate of ECMS reached 686 per cent. The staggering growth performance of ECMS is attributed to the low penetration rates in Egypt, and signifies the potential demand that is yet to be met (JP Morgan 2002). Secondly, operating as a duopoly for a five-year period implied that high market shares and subsequent profit margins were to be maintained for a relatively long period. This is reflected in the key performance indicators of ECMS, which exceeded the company's own forecasts.

ECMS signed an agreement and a service-provider license for 15 years with the Egyptian Telecommunications Regulatory Authority, in May 1998. The license cost LE 1.75 billion, in addition to an annual fee to be paid to

Telecom Egypt throughout the duration of the license. It is expected that a new GSM license will be granted in the first quarter of 2003. However, to date there have been no significant bids for the license, and it is probable that the government-owned Telecom Egypt will manage the third network. Entry of the third GSM network is expected to place substantial downward pressure on prices.

The license fee was financed via a US$ 490 million loan from Chase Manhattan, ABN Amro, Société Général and a local bank called CIB. It was imperative that the three strategic shareholders (France Telecom, Motorola and Orascom Telecom) gain controlling interest in ECMS to be able to obtain a loan of this size on the international market. In June 1999, the Egyptian Capital Market Authority approved a bond issue by ECMS, with a total value of LE 340 million to finance the development of the network. The issuance of the bonds was an important step towards a comprehensive financing package, with Chase Manhattan Bank acting as the Global Coordinator.

Restructuring

Following the acquisition in May 1998, the first challenge facing ECMS was to restructure the acquired network and to expand its capacity, while operation was already underway. Quoting ECMS's CEO, the process of restructuring resembled the attempt to "change the engines of an airplane while it was flying". Restructuring was performed at different levels, particularly with regard to the introduction of new generations of mobile communications technology. There was an extensive restructuring and upgrading of infrastructure, including substantial technology transfer by the two contracted suppliers, Alcatel and Motorola.

The company's human resource base was expanded beyond the 50 former employees of Egypt Telecom, who stayed on board following the acquisition. Thus, ECMS did not face the challenge of having to restructure the company's human resource base. The human resource aspect of operations was viewed to have been as 'greenfield as it can get'. The former Telecom Egypt staff who joined ECMS were 'cherry picked' by the new management to avoid any redundancy or layoffs following the acquisition. The ECMS workforce currently stands at 1,700 employees.

Highly qualified top and middle management, engineering, technical, marketing and customer-services staff are presently employed. However, during the initial months of operation, and given the novelty of wireless communications-related services in Egypt, ECMS faced some difficulties in filling some key positions and therefore had to rely on expatriate staff. The picture is completely different now, with the exception of very few posts; Egyptian personnel pre-dominate and the same holds true for ECMS's competitor, Click GSM Vodafone.

Customer-care services were introduced for the first time following the acquisition. ECMS also introduced several innovations such as new differentiated services, particularly for the post-paid lines. The billing system was also completely revamped, and new employees were trained in the use of high technology and in high-standard managerial skills.

When the third GSM operator joins the market, employing the skill levels needed to operate and manage the network will not constitute a serious challenge, as the culture and pool of skills related to mobile communications management and operations is already in place. However, it is likely that the new GSM operator will raid the personnel pool of both ECMS and Vodafone.

ECMS restructured its product range, which prior to the acquisition was confined to the post-paid lines. ECMS provides a differentiated service for the post-paid line, which was given the brand name “Moga”, and a prepaid line service under the brand “ALO”. Prepaid lines are the fastest growing segment of the wireless communications market in Egypt, and to capitalise on this fast growth trend, ECMS has recently introduced installment schemes to finance the ALO line. The third ECMS product is MobiNil Business, which has a special corporate tariff charge and interconnection fees.

Performance

Compared with other mobile operators in the region, MobiNil is showing significant advantages in terms of key financial indicators. MobiNil is among the few operators in the region able to generate return on invested capital that is higher than its already high cost of capital. This fact has added to shareholders’ value. Many mobile operators in the MENA region are currently not able to cover the cost of their capital due to the large capital expenditures of the late 1990s (EFG-Hermes 2002).

We see in Table 4.2 that in the third quarter (Q3) of 2002, MobiNil announced consolidated revenues of LE 770 million for the quarter versus LE 588 million for the third quarter of 2001. Consolidated revenue for the first three quarters of 2002 reached LE 1.9 billion compared to LE 1.8 billion for the same period in 2001. The company’s EBITDA reached LE 431 million representing an EBITDA margin of 56.0 per cent for Q3, 2002. ECMS exceeded the targets for subscriber growth, as active subscribers on September 2002 reached 2.1 million (compared with 1.2 million subscribers with Vodafone) representing a growth of 65.3 per cent in active subscribers from the same period last year (Egyptian Company for Mobile Services 2002).

Table 4.2 ECMS Key performance indicators

Indicator	1999	2000	2001	2002
Revenues (LE 000)	1 500 000	2 117 033	2 320 183	1 948 481
EBITDA (LE 000)	490 4	925 554	1 065 301	1 025 589
EBITDA (%)	32%	44%	45.9%	52.6%
Net Income (LE 000)	n/a	291 529	340 815	370 823
Active Subscribers	540 000	1 210 000	2.034	2 132

Source: www.MobiNil.com

Competition

ECMS's competitor is Click GSM Vodafone (formally Click GSM), which was the second GSM operator to be granted a license to operate in the Egyptian market. Click GSM Vodafone (hereafter Vodafone) started as a joint venture between Vodafone, Airtoch and the two local partners, Alkan and EFG-Hermes. Vodafone is an international brand name in the world mobile communications industry, with operations in 25 countries and a consumer base of some 65 million subscribers. While Vodafone and ECMS acquired their GSM operating licenses at roughly the same time, the former was a typical greenfield project, having to build the network infrastructure before commencing operations in November 1998. Vodafone currently holds a 60 per cent stake in Click.

Competition between the two operators has put downward pressure on prices, particularly on interconnection fees. Vodafone was the first to introduce prepaid services, with the presence of the two competitors driving prices. The tariff structure and connection charge for the two GSM service providers are very similar, and these may seem to imply subtle collusion. However, collusion between ECMS and Vodafone is in fact unlikely, as is the probability of exploiting their duopolistic market position. The Telecommunications Regulatory Authority maintains strict control over the movement of tariffs charged by the two companies.

Resources

ECMS inherited a small GSM 900 network with Alcatel technology from Telecom Egypt, serving only 83,000 subscribers in Cairo and Alexandria, with two switches, and less than 100 stations. Since May 1998, and with the increase in the company's switches and stations, the ECMS network now covers all major cities in Egypt, achieving the required coverage specified in its licensing agreement. ECMS has either replaced or relocated the low quality stations, which caused network inefficiency during the initial acquisition period. At present, all of the company's obsolete stations have been replaced, with current stations reaching 1,131.

The technology needed to support a GSM network has to adhere to standard worldwide specifications, since GSM networks worldwide are interconnected to sustain inter-network traffic. Following the acquisition of the government owned and managed GSM operator, ECMS contracted Motorola to supply the latest technology for its stations and other communications equipment. Motorola was also responsible for the upgrades of existing base stations. The French company Alcatel supplied new switching equipment to support the planned increase in network capacity as well as to enhance the quality and consistency of services provided. ECMS has retired the old generation GSM technology or had it re-deployed elsewhere.

When Motorola was first contracted as a vendor, it supplied the latest technology base stations and other vital communications equipment in a large number of areas, which were not previously covered when GSM services were first introduced in Egypt. Motorola was also responsible for the key upgrades of the base station equipment, and hence the quality of service and number of lines available. Together, Motorola and Alcatel supplied new switching equipment to support more mobile lines, increasing the quality and consistency of service to ECMS customers, as well as supporting new subscribers. Alcatel supplied significant upgrades to the existing switching equipment and new high technology base stations. When ECMS took over the government-owned GSM operator in Egypt, one of the first tasks was to survey the infrastructure available, add new capacity and expand the network, to measure up to world standards. The outcome, which is summarised in Table 4.3, was a significant improvement in the quality of services (www.MobiNil.com).

Cairo is one of the most densely populated cities of the world, a fact that could have complicated the expansion of MobiNil's GSM network. However, with Motorola's background in the deployment of GSM networks, the solution to overcoming the problems of underground ducting for telecommunications services was to install the latest Free Space Optical (FSO) transmission systems.

ECMS also launched wireless information services in May 2000, employing Motorola's WAP technology. The Wireless Application Protocol (WAP) allows mobile users to access and interact with information services. ECMS was the first mobile service provider to deliver WAP to the Middle East and among the first to introduce WAP services in the world. WAP services also allow for the extension of e-commerce to wireless communications users http://www.MobiNil.com/en/pressandmedia/pressrelease).

Table 4.3: ECMS operational highlights (2001 and 2002)

	Added In Q4 2001	2001	Added In Q3 2002	2002
Total No. of sites	106	1,659	54	1817
Total No. of switches	2	13	0	13
Total No. of cities covered	9	234	11	255
Total No. of highways covered	2	53	2	61

Source: www.MobiNil.com/en/pressandmedia

ECMS will be introducing the next generation of mobile technology to Egypt, having made the first experimental General Packet Radio Service (GPRS) call in Egypt. GPRS technology will bring close to 10 times more bandwidth to the mobile network.

The company's resources are not confined to the latest world technologies but they also include its human resources, especially those with outstanding managerial skills. A shareholders' agreement, with a built-in conflict resolution mechanism, governs the appointment of key management positions in ECMS. Managerial control is shared between the two majority shareholders, France Telecom and Orascom Telecom. France Telecom appoints the Chief Executive Officer, who is also Chairman of the MobiNil Consortium. The current CEO, a Lebanese national, has a prior track record of employment with France Telecom. The decision to employ a Lebanese national to manage the stake of France Telecom in ECMS proved to be an excellent hedge, which has worked in favour of ensuring cultural harmony when working with Egyptian nationals.

Orascom Telecom appoints the Chairman of the Board, and the Chief Government Affairs Officer. The Chief Financial Officer was appointed by Motorola prior to its departure, and has retained his position beyond its exit.

As mentioned earlier, the technology needed to operate a GSM network is, by 2002, rather standard, and is easy to source, operate and maintain. This fact brings management expertise to the forefront as one of the most important ingredients behind the success of GSM network operations. Clearly, the combination of the management track records of both France Telecom and Orascom Telecom has been instrumental in the operating success of ECMS. In fact, the performance of ECMS may have encouraged the various bids of Orascom Telecom to acquire stakes in GSM networks in Africa and the Middle East.

Counterfactual

Without the acquisition, it was most likely that ECMS would have acquired the second license offered by the Telecommunications Regulatory Authority, which was taken up by its competitor Vodafone. ECMS would have eventually established the second GSM network in Egypt. The scenario to follow the switch in roles and entry dates would have been the same apart from the reversal of the current brand names of existing operators. Both competing companies in the Egyptian market have forged strong partnerships in which foreign players with strong global presence in the mobile telephony sector provided the know-how, while the local partners provide the necessary local market intelligence and culture-sensitive insight.

Concluding Remarks

The Egyptian Company for Mobile Services (ECMS), known in the market as MobiNil, started as a consortium of France Telecom, Motorola and Orascom Telecom. However, Motorola left the consortium in 2001 to avoid the negative consequences in the telecommunications equipment market as a result of being identified as a shareholder in one of the competing service-providing companies in Egypt.

ECMS acquired the state-run network in May 1998 and enjoyed the advantages of the first mover. It is a joint stock company with 51 per cent of its shares owned by MobiNil, 16.6 per cent by Orascom Telecom and 32.4 per cent by stockholders. Moreover, MobiNil's shares are divided between France Telecom (71.25 per cent) and Orascom Telecom (28.75 per cent).

Not only has ECMS managed to overcome the restructuring challenges in upgrading the 100 inherited stations and recruiting skilled labour in the emerging field of telecommunication, but it has also improved its managerial and technical capacities to meet global standards.

The number of subscribers jumped from 83,000 to 2 million between 1998 and 2001, enabling the company to grow at an annual rate of 686 per cent, on average, during the same period. ECMS has also introduced new services to the local market such as the Wireless Information Services in May 2000. The company also launched the first General Packet Radio Service (GPRS) in 2002. These efforts for continuous improvement were aimed at preserving the company's leadership position and market share in Egypt.

Building on the experiences in EDMS, the local partner Orascom has itself grown into a multinational firm and become a major player in the MENA region. Its successful bid for the central licence in Iraq in 2003 is indicative for its newly gained competencies.

Table 4.4 Top five research-based pharmaceutical companies by market capitalisation

	Market capitalization (US$ million)	Pharmaceutical sales 2001	R&D spent 2001	Pharmaceutical growth (%) 2000-01	Headquarters
Pfizer	249,365	26	4.8	13	New York
Johnson & Johnson	193,162	15	1.1	19	New Jersey
GSK	146,281	25	3.8	12	London
Merck	125,407	21	2.4	5	New Jersey
Novartis	101,686	15	2.2	15	Basel
Egypt GDP	93,800	---	---	---	---

Sources: Pharmaceuticals Executive (2001) Available at (www.pharmaexc.com)

GLAXOSMITHKLINE (GSK) EGYPT

The Industry

The pharmaceutical industry has been classified as a 'sunrise' industry of the future. The term sunrise is the optimistic adjective to describe a range of industrial activities that share a set of common characteristics of being "…relatively new, technologically progressive concerns investing heavily in R&D in order to foster not only growth but, more fundamentally, survival given the high vulnerability of their products to rapid technological obsolescence…" (Wells, 1985:11). Sunrise or new-economy industries include companies operating in the fields of electronic data processing, electrical and electronic engineering, aerospace and pharmaceuticals. The pharmaceuticals industry distinguishes itself from other manufacturing activities with its research intensity, as the share of sales allocated to research and development (R&D) has currently reached 18.5 per cent, up from 11.4 per cent in 1970 (PhARMA 2002). These figures are unrivalled by any other new economy industry.

Two types of manufacturing activities characterise the supply side of pharmaceutical production. Research-based companies produce breakthrough drugs, which are patent protected, and normally invest heavily in R&D. Generic manufacturers produce off-patent products, with production costs basically divided between manufacturing and marketing.

Judging by market capitalisation figures, research-based pharmaceutical companies control huge financial resources, a fact which has effectively awarded this group of TNCs financial power that exceeds the GDP of developing countries. Egypt is a case in point (Table 4.4).

Pharmaceutical products are highly differentiated, and therefore, can only be grouped in sub-markets within which only a reasonable degree of substitutability of one product for the other exists. Competition is assessed within the domains of particular therapeutic groups of drugs. Further distinction is made between in-patent products and generics, as well as between ethical products and over the counter (OTC) drugs. OTC drugs can be obtained without prescription and dispensed outside the regular pharmacy. These distinctions carry significant implications in terms of the cost of production, pricing, entry barriers and competition.

In-patent drugs, referred to as single-source drugs, have a relatively high fixed R&D cost in relation to the total cost of production. In a single-source drug market, higher prices are reinforced by limited competition due to patent protection, which is one of the most significant barriers to entry. Product competition is usually more important than price competition. That is, the ability to create new medicines is more important than the ability to produce them cheaply (Howells and Neary, 1995). Once a product is off patent, drug manufacturers enter what was once a single-source drug sub-market by providing generic versions, which significantly undercut the price of the original brand. In the generic or multiple-source drug market, patent protection is absent and entry barriers are relatively low.

The Egyptian market for pharmaceuticals is estimated at US$ 1 billion, with local production covering roughly 94 per cent of local demand by volume (American Chamber of Commerce in Egypt, 2001). Sales have increased by over 150 per cent from 1991 to 2002 (Ministry of Health and Population 2002). The Egyptian pharmaceutical market is a predominantly multiple-source drug market, in which the production of generics has proliferated under the auspices of a patent regime (Law 132 of 1949), which only provides patents for processes. Subsidiaries of foreign multinationals produce virtually all of their products under license for the parent company. On the other hand, domestic private and public firms produce close to half of their products under license, while the rest fall under the category of generics (Subramanian and Abd-El-Latif 1997). The case of Egypt is typical of non-major developing country markets, in which generics usually represent more than 30 per cent of the total market by value and 40 per cent by volume (Southworth 1996).

Egypt is a member of the World Trade Organisation (WTO), and will, therefore, be obliged to enforce higher standards of intellectual property rights in conformity with the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The TRIPS Agreement stipulates the provision of a standard 20-year period of patent protection for pharmaceutical products, and is therefore likely to significantly change the pharmaceutical market outlook in Egypt. It is important to note that foreign companies operating in the Egyptian market have collaborated and account for a powerful lobby in urging the Egyptian government towards a speedy respect of the TRIPS Agreement. Generic manufacturers in Egypt (mainly local firms) will have to respect the 20-year period of exclusivity awarded to patent owners. Otherwise, production can only take place under license from the patent owner.

In addition to being a multiple-source drug market, one of the distinctive characteristics of the Egyptian market for pharmaceutical products is the *de facto* absence of distinction between ethical and OTC products. This blur has significantly influenced demand for pharmaceuticals. With the exception of a short negative list of products (falling in the general category of narcotics), virtually all pharmaceutical products can be obtained without prescription. Self-prescription is extremely common in Egypt, which explains the very high per capita intake of antibiotics, relative to other markets. Another feature of the Egyptian pharmaceutical market is the relatively low prices of pharmaceutical products, a function of tight government pricing polices for the sector. Pharmaceutical prices in Egypt tend to be among the lowest in the world.

The Investor

The merger between GlaxoWellcome and SmithKline Beecham in January 2001 resulted in the creation of the second-largest pharmaceutical production entity in the world (ranked by global sales), with an estimated 7 per cent of the world's pharmaceutical market. GlaxoSmithKline (GSK*)* pharmaceutical sales currently stand at US$ 24.8 billion, and the company's net profit is US$ 6.5 billion. While GSK is headquartered in the UK, the company's operations are truly global. (GSK) has over 100,000 employees worldwide, close to half of which (42,000 employees) work at 107 manufacturing sites in 40 countries (GSK 2002).

The GSK R&D budget of US$ 4 billion is the largest in the industry. Over 16,000 employees work in the field of R&D. It is important to note that GSK*'*s R&D operations are less globalised than manufacturing and marketing. R&D is concentrated in 24 sites in seven countries, mainly in Europe and the US. In recent efforts to capture a share of emerging bio-technology activities in less developed regions of the world, GSK expanded its R&D activities to China, which is the largest healthcare market in the world.

GSK has a long track record of mergers and acquisitions, the largest of which has been the merger between Glaxo and Wellcome to form GlaxoWellcome in 1995, and that between GlaxoWellcome and SmithKline Beecham, which began in 2000 and was executed in 2001. The latest merger has targeted the restructuring of manufacturing activities, designed to allow the company to make savings of US$ 2.57 billion by 2003 (GSK 2002).

GSK has manufacturing facilities in several countries in Africa and the East, including Egypt, Kenya, Morocco, South Africa, Israel, Saudi Arabia and Turkey.

Acquired Local Firm

The history of GSK Egypt dates back to the 1980s, with a series of mergers and acquisitions. In 1981, Glaxo acquired minority ownership in Advanced Medical Industries (ABI), one of the local pharmaceutical companies. In less than ten years, this partnership advanced what was a relatively small company, with no profits and a market share of 1 per cent (and a market rank of 22nd) to a consolidate its market presence. In 1990, Glaxo Group Limited acquired controlling interest of 51 per cent in ABI, taking over the management. Further consolidation followed in 1991, when the Group acquired 69 per cent of the company's stock. In 1992, the company changed its name to Glaxo Egypt S.A.E. with the controlling interest of Glaxo increasing and reaching 87.8 per cent.

Following the merger of Glaxo and Wellcome in 1995, the name of the company was changed to Glaxo Wellcome Egypt. During the same year, Glaxo Wellcome increased its stake of Glaxo Wellcome Egypt to 90 per cent. The remaining shareholders were composed of a small group of institutional investors. Following the merger between GlaxoWellcome and SmithKline Beecham in January 2001, the name of the company was changed to GSK Egypt.

Table 4.5 Chronology of acquisitions by GSK Egypt 1981-2002

1976	Advanced Medical Industries (ABI) established.
1981	Glaxo acquired a minority ownership in Advanced Medical Industries.
1989	Advanced Medical Industries sold its manufacturing facility in Egypt to Glaxo.
1990	Glaxo Group Limited acquired controlling interest (51 per cent), taking over management of ABI.
1991	Glaxo Group Limited acquired 69 per cent of ABI's stock.
1992	ABI name changed to Glaxo Egypt S.A.E., with controlling interest reaching 87.8 per cent.
1995	Glaxo and Wellcome merger executed and the name of the company changed to Glaxo Wellcome Egypt.
1999	Glaxo Wellcome Egypt acquired 97 per cent of APIC.
2001	Merger between Glaxo Wellcome and SmithKline Beecham, and name of Glaxo Wellcome Egypt was changed to GSK Egypt.

The history of the acquired local company goes back to 1976. Amoun Pharmaceuticals was among the first private companies to be established in the Egyptian pharmaceutical sector after the enactment of the Investment Encouragement Law 43 of 1974, which opened the field to private investment. The company was initially founded as an import and distribution company, but developed to become one of the fastest growing companies in the Egyptian pharmaceutical market.

In 1989, Advanced Medical Industries (ABI) - the first of the companies owned by Amoun - sold its private sector manufacturing facility in Egypt to Glaxo. The owner, Dr. Sarwat Bassily, already had another manufacturing facility, and his second company Amoun Pharmaceutical Industries Company (APIC) was then ranked fourth among Egyptian pharmaceutical companies.

In January 1999, Glaxo Wellcome Egypt acquired 97 per cent of APIC, which at that time held a 3 per cent share of the local market. The acquisition, which cost LE 387 million (£70 million), elevated Glaxo Wellcome Egypt to pharmaceutical market leader in Egypt, with the company's market share increasing from 6 per cent to around 9 per cent. Amoun currently operates its third company, described below, the two spin-off acquisitions by GlaxoWellcome in 1989 and 1999.

Table 4.6 Top acquisition deals- outside North America and Europe

Value $m	Target Name	Country	Bidder Name	Country
339	Torii Pharmaceutical	Japan	Japan Tobacco	Japan
132	South African Druggists	S. Africa	Fedsure Holdings	S. Africa
106	**Amoun Pharmaceuticals**	**Egypt**	**GlaxoWellcome**	**UK**
42	Chia Tai Health Products	China	Shanghai Industrial.	Hong Kong
33	Hoechst South Africa	S. Africa	Hoechst	Germany
24	Merind	India	Wockhardt	India
23	Pfizer Korea (Pfizer, Shinwon)	S Korea	Pfizer	US
14	Roche Products-Hisinchu Factory	Taiwan	Utd Biomedical	US
14	Hubei Zenith Pharmaceutical	China	Hubei Zenith Group	China
12	Chongqing Medicine	China	Chongqing Taiji	China

Source: PriceWaterhouseCoopers (1999) "Pharmaceutical Sector Insights".

The acquisition of APIC by GSK was the third largest acquisition worldwide in the pharmaceuticals industry that year.

The proceeds of the sale have been used to expand APIC's parent company's new facility in one of the industrial zones around Cairo, and will probably become one of the largest pharmaceutical manufacturing facilities in Egypt. The owner of the acquired company has also retained the brand name of his original company, Amoun. Amoun is a major pharmaceutical exporter in Egypt, exporting to a number of countries, including the USA, Romania, Russia and 14 Arab states.

The sale by Amoun of its two companies ABI and APIC constitutes a precedent in Egypt where one company twice acquires another company from the same owner. Following the acquisition, GSK Egypt took over the physical premises of APIC, which are located back-to-back with the GSK Egypt factory, another strategic reason to have acquired the company, so as to allow expansion of already existing manufacturing facilities in the same geographic location and close to management headquarters.

The most important intangible asset that motivated GSK's interest in acquiring both ABI and APIC was the market shares held by both companies at the point of acquisition. The sales forces of the two companies and their knowledge of the local market was an extra benefit of the acquisition.

It is also interesting to note that the owner of both ABI and APIC planned to sell assets in one company while having another subsidiary already operating in the market. The notion that TNCs will eventually drive local businesses out of the market as a result of their acquisition strategies has been refuted by the experience of GSK in Egypt.

Motives for Setting up Operations in Egypt

Generally speaking, the decision of a pharmaceutical company to invest abroad is based on the commitment of resources for the purpose of earning a financial return, or with the expectation of gaining future benefits. Generic motives for investing in third country markets include the availability of raw materials, the ability to carry out sophisticated chemical syntheses, and the availability of the workforce (Wescoe 1985).

Another important reason behind the decision of many TNCs to operate in the Egyptian market is related to the nature of the pharmaceuticals market in general. The worldwide market for pharmaceuticals is highly fragmented, which means that there is a considerable degree of variation in the regulatory regimes across countries, which in turn makes it easier to set up manufacturing facilities locally in order to cater to local demand. This is particularly true in the case of relatively large markets.

Like most subsidiaries of research-based pharmaceutical companies located in developing regions, GSK Egypt is only involved in formulation activities, which means that it imports bulk chemicals and processes them in

Egypt into their final dosage forms. Hardly any R&D takes place in Egypt, with the few exceptions of the development of some products for local conditions.

When GSK first commenced production in Egypt (as Glaxo) scope for catering exclusively to the local market was very attractive, with a consumer market of some 60 million inhabitants. However, low per capita income was a deterrent against bringing in the whole portfolio of GSK products to the Egyptian market. For this reason, a brownfield entry mode seemed to provide the perfect fit with the strategy of Glaxo at this point in time (early 1980s). Forming a partnership with an already existing local company enabled the relatively expensive product portfolio of Glaxo to be augmented with the complementary portfolio of the local partner company.

One of the major incentives for the company to choose this model of acquisition is the "jump-start". It is much easier for a company to start operating in an already existing framework, with existing licenses, approvals, buildings, and infrastructure (even if it is basic) and more importantly an existing market. In the case of GSK it is obvious that the major incentive for the acquisition was not the existing machinery or production line, since there was a major technology transfer, restructuring and extensive replacement of capital equipment. The major incentive was the already existing market share, as well as the fact that the acquired local company was located back-to-back to the GSK factory and management headquarters, which meant that any future expansion could be easily accommodated.

The former managing director, who engineered the two acquisitions of ABI and APIC, was asked about what he would choose by way of entry mode, if given another chance. The prompt answer was: "greenfield". From the viewpoint of someone who went through a brownfield experience, greenfield entry in the domain of pharmaceutical production is perceived to best serve the company's objectives and goals for a longer-term vision. Brownfield proved to be time consuming and burdensome, especially when integrating the administrative bodies of the two companies during the initial phase of the acquisition. Greenfield entry could have helped the business expand without having to put up with an obsolete infrastructure. The burden of restructuring, having to deal with redundant labour, and training needs of the acquired company's workforce are yet another problem associated with brownfield modes of entry. It is important to mention that several of the foreign pharmaceutical companies launched their operations in Egypt as greenfield, foremost among which has been Bristol Myers Squibb, which was the first wholly-owned foreign subsidiary to operate in the Egyptian market.

Entry Formalities

The pharmaceutical-drug regulatory regime in Egypt is composed of three major government bodies. The Central Administration of Pharmaceutical

Affairs (CAPA) grants the license for a company to commence manufacturing; the Drug Planning and Policy Centre (DPPC) is responsible for product registration and pricing; and the National Organization for Drug Control and Research (NODCAR) conducts physical, microbiological, pharmacological and bioavailability testing involving human volunteers The three bodies fall under the umbrella of the Ministry of Health and Population (MOHAP).

Product registration and pricing are the most cumbersome product entry hurdles facing pharmaceutical companies in Egypt. While registration requirements are fairly straightforward, whereby the provision of a "free sales certificate" in one of five reference industrialised countries is the basis for obtaining approval, a lag of two to three years usually occurs between the introduction of a product in one of the reference countries and its marketing in Egypt.

No more than four identical products, in terms of therapeutic value and dosage, are allowed to be sold on the Egyptian market, with the exception of products intended for export sales or for public tenders on the local market.

Pricing is the second hurdle. Pharmaceutical products in Egypt are priced on the basis of a cost-plus formula, to ensure both the affordability of medicine and to guarantee a positive profit on all drug products sold (Nathan Associates 1995). The profit-margin ceiling is 15 per cent for essential drugs, 25 per cent for non-essentials and 40 per cent or more for OTC drugs. Pricing policies and price controls contribute to the fact that local prices of pharmaceuticals in Egypt are sometimes 80 per cent less than their imported equivalents according to Prime Research (1997).

Restructuring

GSK Egypt has a long track record of restructuring, associated with having gone through two major acquisitions in Egypt as well as two mega-mergers globally. The first episode of restructuring ensued when Glaxo acquired the minority stake in ABI. ABI began to manufacture the products of Glaxo locally, which necessitated adherence to higher manufacturing standards and specifications, as well as training of the sales staff to market the new products.

The second episode of restructuring, which followed the increase in Glaxo's stake in ABI in 1990, and the change of the company's name to Glaxo Egypt, was more comprehensive as the new management restructured the whole firm and substantially increased investment, particularly in the plant and equipment.

Table 4.7 Pricing structure for pharmaceutical products in Egypt

Local Products		
	Index	
Ex-factory price	100.00	Price to distributor
+ Distributors' mark-up (12.36%)	112.36	Price to pharmacist
+ Pharmacists' mark-up (25.00%)	140.45	
+ Sales tax (5%) of ex-factory price	145.45	
+ Medical stamp	145.50	Price to public
Imports		
	Index	
CIF price	100.00	
+ Import taxes (11.55%)	111.55	Landed cost
+ Importers' mark-up (6.4%)	118.65	Price to distributor
+ Distributors' mark-up (7.53%)	127.63	Price to pharmacist
+ Pharmacists' mark-up (13.64%)	145.03	
+ Taxes (1.63% of CIF)	146.66	Price to public

Source: AIDMO (2000)

There was a complete turnover of employees and a restructuring of the whole management and personnel systems. The company's personnel policy and attitude was marred by the 'jobs for life' culture, which proved highly problematic. The company's headcount, which was 741 at entry, was gradually increased to reach 1,550 by 2000. Between 1990 and 2000 some 380 workers were made redundant and 1,190 new employees were hired. A large-scale programme was instituted to retrain and reorient existing workers and enable them to assimilate the latest imported technology, with a major shift of emphasis from manual to automated systems. As part of the restructuring, both manufacturing facilities and the distribution system were totally rebuilt.

In 1995, the merger between Glaxo and Wellcome in turn necessitated restructuring on the local front, as a host of Wellcome products were added to the company's product portfolio.

As a result of the acquisition of APIC in 1999, GSK acquired the domestic and export rights to 30 APIC products, including vitamins, antibiotics and analgesics, as well as APIC's production facilities. Up to 300 APIC employees were hired by Glaxo Wellcome and were mainly employed in the sales domain. It was also important, however, to retain the sales force of APIC to be able to maintain the links with the acquired company's network of physicians and pharmacists who promote APIC's products. The retention of the 30 APIC products was a strategic decision to complement Glaxo Wellcome Egypt's existing business. The nature of the acquisition enabled Glaxo Wellcome to supply the Egyptian Pharmaceutical market with the broadest range of cost effective medicines. It also significantly strengthened the company's OTC franchise.

It is, however, important to note that the manufacturing facilities that were acquired from APIC (manufacturing site, machinery and equipment) have not been put to use by GSK Egypt. The post-acquisition assessment of APIC's manufacturing site revealed the need for a significant upgrade in order to fit with GSK manufacturing standards and specifications. The intention following the acquisition was to demolish the APIC site and expand the manufacturing facilities of GSK Egypt.

The most significant of the restructuring episodes, undertaken by GSK Egypt, started in 2000 to prepare the Egypt manufacturing site as one of the supply hubs to 66 markets in Africa, the Middle East and some parts of Europe. This decision was part of a global Strategic Master Plan (SMP) to restructure GSK's worldwide manufacturing and marketing operations. The SMP will create a specialisation based on the product life cycle, whereby some sites will specialise in the production of drugs in the early phases of their product life cycle, while others specialise in more mature products. Most multinationals operating in Egypt, do not use Egypt as an export base to other markets. The SMP has for the first time placed Egypt in a position as a potential export springboard to neighbouring regions, thus validating the argument that the Egyptian pharmaceutical industry holds strong potential as a low-cost base for the 'production' of pharmaceuticals. Whether a demonstration effect by other foreign TNC's will follow is yet to be known.

The SMP has had restructuring implications for the product portfolio of GSK Egypt. A group of products, which were already registered, manufactured and sold in Egypt, were discontinued in favour of importing them at the same cost as those sold on the Egyptian market. A host of new products were added to the local portfolio. Some new products were also added exclusively for export. The process of reconfiguration of the product portfolio of GSK Egypt, in order to complete the restructuring process and prepare the Cairo location to act as the regional supply hub, was initially not welcomed by the regulatory authorities in Egypt. Concern over health care policy objectives, of guaranteeing a sufficient supply of already existing products, was given priority over industrial policy objectives of promoting Egypt as an export base for pharmaceuticals.

The last of the restructuring efforts to date took place following the merger between Glaxo Wellcome and SmithKline Beecham in January 2001, to integrate the products of the latter.

Performance

The main activities of GSK Egypt are the manufacturing, packaging, marketing, selling and distributing of GSK products. GSK Egypt also imports and distributes a range of products of the parent company that are not manufactured in Egypt. In addition, GSK Egypt manufactures a range of products under license from other pharmaceutical manufacturers.

Like most foreign owned subsidiaries, new in-patent products are only manufactured locally after a lag between their initial launch in the major markets of the US and Europe and being manufactured in Egypt. This lag is mainly attributed to the lack of a strong patent regime needed to deter infringing activities, and secondly to the absence of the relevant technology needed to manufacture sophisticated products.

GSK Egypt currently assumes the lead position as the number one pharmaceutical firm in the Egyptian market, with a market share of close to 9 per cent. A loss-making company of LE 2 million in 1991 was completely revamped and was transformed into a profit-generating company in 2001. Total sales increased from LE 142 million in 1994 to LE 390 million in 2001, and market shares increased from 6 per cent to 9 per cent over the same period.

Table 4.8 GSK market share (%) for selected market (LE million) and years

	1994	1995	1996	1997	1998	2001
Selected Market (LE million)	2.285	2.569	2.735	3.357	3.491	4.334
Glaxo Wellcome Egypt	6.2	7.2	7.5	7.8	8.4	9.9*
BMS Egypt	6.2	6.2	6.2	5.5	5.8	5.3
Eipico	4.9	5.1	4.8	5.0	5.1	4.8
Pfizer Egypt	3.5	3.9	4.4	4.1	3.9	3.8
Pharco	3.7	3.8	4	3.6	3.5	3.8

* The total shares of GSK plus Amoun
Source: IMS, 2002

GSK Egypt is the only foreign company engaged in export activities in Egypt, mainly to markets in the Middle East and Africa. The large number of Egyptian physicians working in the Gulf region have been playing an important role in promoting the drugs manufactured in Egypt. GSK Egypt seems to have been capitalising on this fact since it started exporting from Egypt during the 1990s. GSK exports are projected to increase substantially, following the full implementation of the SMP.

Competition

There are 29 firms with manufacturing facilities for final pharmaceutical products in Egypt, covering more than 94 per cent of local demand (by volume, GSK Egypt currently ranks first in the Egyptian market in terms of sales value and volume). GSK Egypt's immediate competitors are the subsidiaries of foreign companies operating in Egypt, as well as local private sector companies. Most of these companies (foreign and local private) were established in Egypt after 1974, following the enactment of the Investment Promotion Law 43 of 1974, which was designed to encourage foreign and local private-sector participation in an economy that was dominated by public sector ownership.

Pharmaceutical manufacturers do not compete for the whole range of products available on a market. Instead, competition takes place within the domains of specific therapeutic groups of drugs. Within each of the top five therapeutic groups on the Egyptian market (in terms of sales value), GSK holds a prominent rank among the top five manufacturers.

Because of low per capita income in Egypt (US$ 1,300), competition between pharmaceutical companies is mainly based on price. Quality is relatively standard in the pharmaceutical industry, with prices becoming the most important factor when prescribing medication, particularly for patients covered by public health insurance schemes. However, foreign companies, like GSK Egypt for example, usually have their products priced at a much higher value than their local counter-parts (for drugs with identical generic composition). The lower prices for pharmaceutical products in Egypt are usually charged by the public sector companies, which had the majority of their products priced during a period when price controls were prevalent for public sector output.

In Egypt, it is very difficult to adjust the prices of pharmaceutical products to accommodate inflation and changes in the cost of raw material inputs that are usually very sensitive to any movements in the exchange rate. There have been mounting complaints that the successive devaluations of the Egyptian pound against the dollar have increasingly affected the profitability levels of all pharmaceutical companies operating in Egypt, local and foreign alike. The pharmaceutical industry in Egypt is import intensive (the industry imports more than 90 per cent of all its raw material), and is therefore highly vulnerable to movements in the exchange rate while having prices fixed at the other end of the chain.

In the face of the inflexibility exercised by the regulatory authorities over price revision in the face of inflation and devaluation, drug manufacturers in Egypt have managed to deal with stringent price revaluations by resorting to a process called ‘vintaging’. Vintaging means “that identical products introduced at different times will be sold at different prices, with the more recent ‘vintage’ products being sold at a higher price” (Nathan Associates 1995).

Resources

The GSK plant is located in El Salam City near Cairo International Airport on an area of 55,000 m^2, of which the manufacturing plants occupy 15,000

m^2. The GSK staff is the most important resource of the company, having currently reached 1,057 employees. GSK Egypt invests heavily in the training of its staff, both at the Cairo manufacturing site as well as at the UK headquarters. GSK Egypt has achieved universal training for its staff at the Cairo manufacturing site, whereby every single employee in the organization has been trained in his or her own professional field.

From the outset, development of the Glaxo Egypt operation has had three major components. First, efforts to establish a total quality management system led to ISO 9002 certification from the British Standards Institution in 1997, the first pharmaceutical company in the Middle East and Africa to achieve this. GSK was also awarded the ISO 14001 in 1997, reflecting their commitment to environmental management. Similar success has been achieved in certification for manufacturing resource-planning processes. Second, the company invested LE 2 million in a development laboratory in 1995 with the principal objective of developing products off patent. Since 1992, 61 product forms have been registered. Four people are presently involved in development and 40 in quality assurance and control. Third, the company has taken its initial steps towards exporting and is the first pharmaceutical TNC in Egypt to market outside the country. Approval has been given to supply Qatar, Yemen and Nigeria, and exports to the latter were worth around LE 3 million in 1997. There are hopes that Glaxo Egypt will be granted the regional mandate to become one of two supply sources for Glaxo Welcome for the Middle East and African market.

As for most pharmaceutical companies, there is no 'direct to consumer advertising', which although it could be done at a relatively low cost through the mass media, is not allowed for the pharmaceutical industry in Egypt. All companies, therefore, have to rely on highly trained sales staff, who make regular visits to physicians and pharmacists to promote the company's products. The sales staff of GSK Egypt is regarded as one of its most important resources and great investment is made in their training.

Concluding Remarks

Glaxo first entered the Egyptian market in 1981 by acquiring a minority ownership in a local company (ABI). Ten years later, the group extended its share to reach 87.8 per cent and changed the name of the company to Glaxo Egypt SAE After the group's global mergers with Wellcome in 1995 and SmithKline Beecham in 2001; the company's name became GlaxoSmithKline (GSK) Egypt.

The brownfield mode of acquisitions provided the company with the jump-start it needed and enabled it to diversify its portfolio of products in a way that reduced the expected risks of low per-capita income and price control prevailing in the Egyptian pharmaceutical market.

The restructuring programme went through several phases following Glaxo Group's global mergers with Wellcome and SmithKline as well as its acquisition of the local company APIC in 1999. The impact of the restructuring efforts was positive enough to increase the company's market share from 1 per cent in 1981 to 9.9 per cent in 2001 and to expand rapidly the range of its offered products.

The achievements of GSK Egypt are not confined to the local market in which it has managed to reach the leadership position. But it has been recognised as the only exporting multinational company in the pharmaceutical sector. Furthermore, GSK has successfully invested in both a local development laboratory and in human resources.

CAIRO FOOD INDUSTRIES SAE HEINZ EGYPT

Introduction

Heinz is a global leader in a segment of the processed food industry, and known especially for its ketchup. For its operation in Egypt, it partnered with a Kuwaiti firm, the Kuwait Food Company, which had been established in Egypt for 25 years. The group, also known under its brand name 'Americana', operates as a local franchise partner in the Arab region to global brands in the food and restaurant industries. It contributes both knowledge of the local business environment, and access to franchise restaurants, a key customer group for Heinz's ketchup.

In addition to the local market, Heinz has been developing Egypt as an export base, utilising the favourable climatic conditions for growing tomatoes. It works with local farmers to change their operation modes and logistics to produce tomato varieties, quality and delivery procedures that meet the requirements of industrial food processing.

The Industry

The food processing industry is one of Egypt's oldest manufacturing sectors, relying on the high quality and low-priced agricultural output of the country. The food processing industry accounts for a large yet stable share of output and employment in Egypt, it generates around 15 per cent of Egypt's manufacturing value added and is the second largest industry after the textiles and garment sector. Output was valued at around US$ 5.2 billion in 1999.

There are 1,299 establishments (15 workers or more) in the food-processing sector, employing 73,000 workers. Over the past decade, the expansion in land reclamation projects has added over one hundred thousand acres of vegetable and fruit cultivation, which has increased the supply of cost-competitive agricultural inputs to the food processing industry. The

Egyptian food processing industry has been a high growth sector, with an annual growth rate of 22 per cent during the decade of the 1990s, mostly in response to the increase in domestic demand (Ministry of Economy 1996).

Processed food in Egypt is not only fast growing, but also undergoing a major transformation in response to changes in consumer demand, both locally and in key export markets. Traditionally, food would be freshly prepared in the household. Yet, changing work patterns of the urban middle class, including higher female work-force participation, led to an increased demand for convenience food products like frozen vegetables, pre-cooked meals, etc.

The bulk of processed food in Egypt is manufactured by semi-automated small to medium sized plants. The industry is highly diversified in terms of output, with major product groups including preserved foods such as dried, canned and frozen fruits and vegetables, preserved and processed meat, poultry and fish, milk and dairy products, edible oils, sugar and confectionery products, and fermented and distilled beverages.

Several government authorities regulate the industry. The Egyptian Organization for Standardization and Quality Control of the Ministry of Industry issues industrial quality-control certificates for the food processing industry. New processed-food products launched on the Egyptian market have to obtain a license from the Institute of Food Industries. The Ministry of Health and the Ministry of Home Trade and Supply also enforce stringent shelf life standards and product specifications for both processed food and agricultural products.

Imports of processed food products into Egypt have to be inspected by five different government bodies, including the Ministries of Agriculture, Health, Supply and Trade, as well as by the Radiation Department and the Customs Authority. Customs duties on imported food products in Egypt range from 5 to 40 per cent, depending on the status of the product as essential or non-essential (Gilada 1999).

Investor HJ Heinz

HJ Heinz is one of the world's leaders in the branded food processing industry, and is ranked as the 10th largest company in terms of global sales. The company was established in 1869 in the United States as a family run business. The first international expansion by Heinz outside of the USA occurred as early as 1896 with the establishment of its overseas office in London. After years of internal growth, Heinz embarked on a strategy of global expansion and acquired a food processor in the Netherlands, a step that was later repeated in Italy, Portugal, Mexico and many other countries.

At present, Heinz holds the lead position among branded businesses in the majority of the key markets worldwide. HJ Heinz owns several brands including Heinz, Ore-lda, Smart Ones, Classico, Wyler's Delimex. Heinz also produces several products under license such as Weight Watchers, and T.G.I. Friday's. The company follows a strategy of related diversification within the food processing industry, and has in recent years focused its product portfolio on sales of peripheral businesses and acquisitions in the core business areas. The core business areas are ketchup, condiments and sauces (28 per cent of turnover, FY 2002), frozen foods (21.2 per cent), tuna and seafood (11.0 per cent), soup, beans and pasta (12.6 per cent), infant foods (9.5 per cent), and pet products (10.4 per cent).

The Heinz*'s* ketchup brand is one of the high performers in the Heinz product portfolio, with market shares of 60 per cent in the US and 66 per cent in the UK. (Heinz Annual Report 2002). It is one of the best-known brands worldwide and closely associated with the American way of life.

In a recent strategic restructuring, the company revised its portfolio of products, whereby Heinz spun off the US and Canadian pet food, the US tuna, infant feeding, the retail private soup and gravy, and the College Inn Broth businesses. The spin-off businesses will merge with Del Monte Foods in order to create wholly-owned subsidiaries with stronger and better-positioned companies. The objective is to focus the product portfolio on higher margin, higher growth businesses. The two strategic segments that Heinz currently focuses on are meal enhancers as well as meals and snacks (Heinz Annual Report 2002).

HJ Heinz provides more than 5,700 product varieties in more than 50 countries all over the world. In the financial year ending May 1, 2002, Heinz sales reached US$ 9.4 billion, which is more than the entire food industry in Egypt. Worldwide, Heinz employs 46,500 people and generated a profit before tax of US$ 1.3 billion. Over 40 per cent of its sales, assets and profits are generated outside the USA.

Table 4.9 HJ Heinz: global performance indicators (US$ '000)

	2002	2000	1995	1992
Sales	$9,431,000	$8,939,416	$8,086,794	$6,581,867
Cost of products sold	6,093,827	5,788,525	5,119,597	4,102,816
Profit after tax	833,889	890,553	591,025	638,295
Number of employees	46,500	46,900	42,200	35,500
Total assets	10,278,354	8,850,657	8,247,188	5,931,901

Source: Heinz Annual Report, 2002.

In 1990, Heinz management explored the Egyptian market and approached the Kuwaiti Food Corporation to form a partnership. The two companies formed Heinz Egypt as a joint venture, which started production in 1992. Heinz Egypt started with imported tomato concentrate, but gradually shifted to local fresh tomato varieties. The initial investment in 1991 was LE 37.3 million (equivalent to US$ 11.4 million based on the ruling exchange rate in 1991) to set up manufacturing facilitates for Heinz products in Egypt, with a focus on tomato (mainly ketchup and tomato paste) products.

In 2002, Heinz Egypt manufactures and markets tomato-based products, juices, jams and condiments for Egypt and other Arab countries. Manufactured products include Heinz brand, Americana brand and several private labels. The Heinz plant in Egypt has a production capacity of approximately 7,000 tons per annum. Heinz Egypt also exports 35 per cent of its output to markets of the Middle East, mainly to the Gulf Cooperation Council and Saudi markets. Heinz Egypt does not export beyond the regional markets of the Middle East and North Africa. In the Middle East, HJ Heinz has, in addition to the manufacturing plant in Egypt, two manufacturing plants in Israel, established respectively by greenfield in 1999 and by acquisition in 2000. Organisationally, the Middle East is integrated within the European division of Heinz.

The Partner Company

The 'Kuwait Food Company' was established in 1964 as the food-processing arm of the Al Kharafi Group, and is known throughout the Arab world under its 'Americana' brand name. It has been listed on the Kuwait stock exchange since 1981. Al Kharafi Group is a private Kuwait-based Group, with diversified interests and activities worldwide. It was established as a trading company more than 100 years ago, and has now developed into an international grade "A" contractor with an annual turnover in excess of US$ 2.2 billion. The activities of the Group cover construction, manufacturing and commerce. The Group has the largest food company in the Middle East. In Egypt, the Group has invested US$ 700 million, divided between the food-processing industry, the tourism sector (which includes the franchise business segment) and infrastructure projects.

Americana was first established as a trading company in Kuwait, but has now developed to become the largest food processing, distribution and retail company in the Middle East. Americana has some 15,000 employees in its branches located in Egypt, Saudi Arabia, UAE, Qatar, Bahrain, Lebanon, Syria, Morocco and Lebanon.

The operations of Americana include trade and distribution of food products, manufacturing (food processing) and the fast-food franchise business. Food processing activities vary according to the market concerned. For example in Saudi Arabia and in Kuwait, Americana is mainly engaged in the processing of meat products as well as baked products. In the United Arab Emirates, Americana has the largest mineral water production facilities as well as canned beans production. Americana also has the largest cold storage facilities in the Arab world.

Americana is a market leader for franchise business in the Middle East. It is the franchisee for KFC, Pizza Hut, Subway, Hardee's, and TGI Friday in Egypt, where the franchise business is estimated to be worth some US$ 158 million and is one of the high performing sectors in terms of generating demand for processed food products. It is expected to be growing at a real rate of 5 per cent. The franchise business is one of the major consumers of Heinz's products in Egypt.

Table 4.10 Kuwait Food Company 'Americana': financial indicators

Year	Assets ('000 KD)	Paid Up Capital ('000 KD)	Equity ('000 KD)	Net Profit ('000 KD)	ROE (%)	ROA (%)
1996	101.84	11.29	37.53	6.46	17.22	6.35
1997	106.28	11.29	42.24	6.89	16.32	6.49
1998	104.18	12.42	46.02	7.64	16.61	7.34
1999	109.05	12.42	54.63	9.60	17.57	8.80
2000	118.01	12.42	58.21	12.07	20.73	10.22

Note: 1 Kuwaiti Dinar = 3.36462 US Dollar

Source: The Institute of Banking Studies (IBS) in Kuwait http://www.kibs.org/kse/kkfcfd.htm

Americana was established in Egypt during the 1970s, following the Investment Incentives Law 43 of 1974, which constituted the legislative foundation of the encouragement of private sector (local and foreign) investment. Incentives provided under Law 43 and its amendments were mainly fiscal in nature, with a five-year tax break on corporate profit, extendable to ten years for projects created in new industrial communities. Most of Americana's business in Egypt is by way of partnerships with American franchises, but in 1991 it also partnered with Cadbury to produce confectionary products in Egypt.

Motives for Setting up Operation in Egypt

Heinz's investment in Egypt has been driven by the objective of accessing local supplies, and by market-seeking motives in view of growing local and regional markets. On the supply-side, Egypt is ranked as the world's fifth largest producer of tomatoes, an attraction for the world's leading producer of tomato-based products. Egypt produces around 5 million tonnes of fresh tomatoes per year. Climatic conditions in Egypt are very favourable for the cultivation of tomatoes, because the time span during which tomatoes can be grown stretches for 120 days each year. Tomatoes can be cultivated three times during the season: once in winter, once in spring and once during the inter-seasonal period called '*al'ourwa'*. This compares favourably with Europe, where fresh tomatoes suitable for the production of concentrate can only be grown for a total period of 45 days.

Not all tomato seed varieties can be used in the processing of concentrates. In Egypt, the soil is very receptive to the cultivation of the seed varieties that are used in the production of tomato concentrate. Heinz has introduced Egyptian growers to a seed variety called University of California 82, specifically developed to be processed into Brix quality tomatoes. Brix quality tomatoes have a higher solid content, which means that in terms of processing, smaller quantities of fresh tomatoes can be used to produce tomato concentrate.

The sheer quantity of fresh-tomato cultivation in Egypt has meant that prices are extremely competitive. Farm-gate prices for fresh tomatoes in Egypt range between US$ 250 to 300 per ton, which is much lower than the competing prices in Italy, Greece, Portugal and Turkey. In terms of production costs, Egypt has one of the lowest average unit costs of production in the region. Yearly performance appraisals conducted for HJ Heinz world-wide manufacturing facilities show that the Egypt manufacturing site is among the best performers in terms of production costs.

Heinz Ketchup is produced almost exclusively with local ingredients procured in Egypt. The main ingredients of tomato products include fresh tomatoes, sugar, vinegar, salt and spices, all of which are available in Egypt. Packaging uses locally manufactured containers for processed food products as the industry is highly developed and competitive in Egypt, and able to meet the specifications required by international manufacturers. Glass containers, labels and cardboard containers are also manufactured in Egypt at very low cost and to high standards. The only imported inputs for Heinz products are the metal bottle-covers, which are yet to be manufactured in Egypt in accordance with Heinz's specifications. The fact that close to 99 per cent of all inputs needed to produce Heinz's products are locally available, has meant that the production process has been shielded against currency fluctuations that may affect imported components, which has affected industries such as pharmaceuticals. Moreover, the quality of local inputs has been the basis for the export success of Heinz Egypt.

On the demand side, Egypt has a very large consumer market with a population of 67 million. The rising per capita income and the shift in consumer tastes in favour of international brand names has increased demand for high value-added processed food products. A host of multinational firms engaged in the food processing sector are already present in Egypt, either as representative offices or with manufacturing facilities in Egypt, including Nestlé, Fine Food (Unilever), Pepsico-Snacks, Cadbury and may others.

The demand for processed food products in Egypt has been accelerated by the growth of the restaurant and tourism industry. Tourism generates huge demand for processed food products, particularly for the up-market qualities and branded goods. Moreover, the fact that Heinz Egypt has formed a joint venture with the largest franchisee for the fast food business in Egypt has added extra strength to the growth performance of Heinz Egypt.

The Egyptian food-processing sector has considerable growth potential owing to the fact that out of the total output of fresh fruit and vegetables, only a small share is being processed into high value-added processed food products. Of Egypt's output of 5.9 million tons of tomato per year, only 2,300 tons are processed. The growth potential of high value added-food processed products remains huge, and has attracted a large number of multinational companies to set up manufacturing facilitates in Egypt (Gilada 1999).

Of no less importance is that Egypt has duty-free access for agricultural and processed food products to Arab countries. Heinz Egypt is the supply hub for a group of the company's products (mainly tomato-based products) to the Gulf region as well as to the Levant area. According to the marketing manager of Heinz Egypt, the company exports nearly 30 per cent of its output to neighbouring Arab markets. Heinz Egypt does not sell to EU markets because of an agreement within the Heinz Group.

Egypt has a relatively generous investment climate in the region, particularly in terms of tax-breaks on corporate profit. The manufacturing plant of Heinz Egypt was established in one of the new industrial communities around Cairo, and has thus benefited from a tax-holiday on corporate profit for a ten-year period after the joint venture began actual production.

Entry

Following the search for a reliable partner in Egypt, Heinz approached Americana, and Heinz Egypt was established and began production as a greenfield project in 1992. While Americana was already one of the key players in the food processing sector in Egypt, the joint venture was considered as a greenfield project, as a newly constituted joint venture was established, with new manufacturing facilities built from scratch.

Initially, the joint venture was 67 per cent owned by Americana, and Heinz held the remaining balance of the shares. While Americana insisted on a majority ownership at the early phase of the joint venture, it gave Heinz the option of increasing its shareholding after the elapse of a five-year period. Currently, Heinz holds a majority of 51 per cent of the shares in Heinz Egypt, while 49 per cent are held by Americana.

The shareholders' structure of Heinz Egypt does not restrict either of the shareholders to specific management controls within the company. In other words, key management positions do not reflect the majority shareholding by HJ Heinz. In fact, certain strategic decisions by the board of Heinz Egypt must be voted on unanimously.

The partnership with Americana has greatly benefited Heinz Egypt. Americana provides extensive knowledge of the dynamics of the food processing industry in Egypt as well as key export markets in the Arab region. Moreover, the access to other businesses of the Americana Group provided the JV with instant market penetration not only in Egypt, but also in other Arab markets, and guaranteed the minimum scale required to make the operation viable.

The joint venture between HJ Heinz and Americana has included an agreement to allow Heinz Egypt exclusive right to sell the range of products manufactured in Egypt in the markets of Egypt, Saudi Arabia, UAE, Qatar, Bahrain, Lebanon, Syria, Morocco and Lebanon. In other words, Heinz Egypt is the exclusive supplier among the Heinz Group to the aforementioned markets.

Competition

Heinz Egypt controls 90 per cent of the ketchup market in Egypt, and 30 per cent of the market for tomato paste and cooking sauces. Within the market segment for ketchup, competition is relatively limited, as Heinz was the first-comer to the market. However, in the area of tomato paste, Heinz faces considerable competition from existing local companies, which were already in operation prior to its entry to the Egyptian market. The two largest competitors are Kaha and Edfina, the two large public-sector companies in the food-processing sector.

While ketchup - the key product of Heinz Egypt - enjoys the number one position in terms of market share, the company also produces a number of what have been termed ‘fighter brands’ that compete with products in lower market segments. To defend its market share in the high growth segment of non-branded products, Heinz Egypt produces a group of brands that do not share the same specifications as the Heinz-branded products and are therefore priced considerably lower. For example, ketchup ‘fighter-brands’ has a higher level of starch as an ingredient, which lowers the cost per pack sold. The same strategy is pursued in other major markets in the Middle East.

Resources and Spillovers

The evolving food-processing industry in emerging markets places new demands on agricultural suppliers to the industry with respect to the quality of the produce, the nature of contractual relationships, and logistics. During its initial years of operation, Heinz voiced concern over what has been termed the “fresh market” approach. As a producer of tomato products, Heinz had to buy tomatoes from different growers, who more often than not sell their output directly to wholesale or retail traders. Growers in Egypt are not used to the notion of having their crops sold to one buyer beforehand, and prefer to take risks on prices at the point of sale, particularly as prices of tomato in Egypt fluctuate sharply depending on the season. International large-scale manufacturers are not accustomed to this fragmented nature of the market. Unreliable supply of fresh inputs, losses during transport, market segmentation and fluctuating prices are major constraints facing the food processing industry. Under such conditions it is hard to deliver a final product, such as ketchup, at consistent high quality and stable prices.

Heinz Egypt helps in developing standards of tomato agriculture in Egypt (www.amcham.org.eg). It has been successful in improving its supply chain, by introducing contract farming to Egyptian growers of fresh tomatoes. Over its years of operation in Egypt, Heinz has established contractual arrangements with growers, both on the large scale as well as on the very small scale, to buy their output on a yearly basis. Farmers are provided with the necessary seed varieties to guarantee the required output specifications. The parent firm provides resources for seed varieties suitable for cultivation in Egypt.

The company has contracted the output of some 500 feddans (one feddan equals 4200.83 m^2). The owners of these agricultural lands benefit from the free extension services provided by a group of Heinz employed agronomists. The outcome of this arrangement has been an increase of 20 to 25 per cent of agricultural yield of contracted land over the average yield of tomato in Egypt. Contracted farming by Heinz Egypt has also introduced growers to the concept of growing fresh vegetables for the sole purpose of industrial production and meeting industrial specifications. Moreover, Heinz Egypt has also introduced safe methods for transporting fresh tomatoes to the manufacturing site, thus reducing wastage in transportation and handling, which elsewhere in Egypt destroys 30 per cent of the annual yield of fresh tomatoes.

The parent company HJ Heinz provides Heinz Egypt with all manufacturing equipment. While the manufacturing process for ketchup, sauces, jams etc. is fairly standard among various manufacturers, certain equipment is exclusively produced for Heinz. The unique manufacturing process for some products, in turn, gives Heinz exclusive know-how and thus market supremacy for these particular products.

Heinz Egypt relies extensively on the training resources of the parent company in the area of production. Employees from the Egypt manufacturing plant are usually trained at the Heinz manufacturing facilities in Italy, with focus on technical skills for new production technologies. To guarantee the specifications required by the parent company, inspection teams from corporate headquarters frequently visit overseas manufacturing plants, including Heinz Egypt.

All Heinz Egypt employees have to go through training once they join the company. Key management personnel travel frequently to attend training courses outside of Egypt. The marketing and training experience of Americana has contributed significantly to the skills of the marketing and sales force of Heinz Egypt. Owing to its early entry, Americana's knowledge and experience of the Egyptian market conditions gave it an edge, in the domain of marketing, over Heinz Egypt. The sales and marketing force of Heinz Egypt attends the same regular generic training courses as the sales and marketing force of Americana. In this way, a synergy has been developed between Americana and Heinz in the area of training.

The brand name is one of the most important resources of Heinz Egypt. In fact, Heinz is often associated with ketchup, perhaps in the same way that the brand name Xerox is associated with photocopying. In export markets, and in addition to the brand name, low-priced inputs play a very important role in the ability of Heinz to export cost-competitive products outside of Egypt.

Heinz Egypt does not advertise extensively in Egyptian media. In fact, the marketing manager of Heinz Egypt has confirmed that this market segment of the food processing industry is not dependent on advertising. Heinz Ketchup is already the number one product on the Egyptian ketchup market, and therefore the returns to advertising are expected to be relatively small.

Given the relatively long history of the food-processing sector in Egypt, the pool of skilled human resources the industry can draw on is fairly large, as is the market in technical specialists. The employees of Heinz Egypt (200 in number) are mainly Egyptian. One of the major strengths of the food processing industry in Egypt is its highly competitive labour force as well as the low priced intermediate inputs. The turnover of Heinz Egypt has currently reached LE 60 million, with a net profit (subject to distribution) of LE 1 million.

Concluding Remarks

Demand in Egypt is shifting rapidly away from traditional freshly prepared, home cooked food and towards processed food products. Heinz Egypt has been able to sustain a virtual monopoly in the ketchup market, reflected in its high market share, as a result of its advantage based on branding and quality production.

Americana has provided Heinz Egypt with guaranteed demand from the fast food sector, in which Americana is the key player. All Americana franchise businesses use Heinz brands. The market experience of Americana in Egypt and in other Arab countries has been a key determinant of the success story of Heinz Egypt, both in the local and export markets.

The case of Heinz Egypt can illustrate spillovers in two forms in particular. Firstly, Heinz provides knowledge transfer through machinery and training in technology and marketing fields. Secondly, Heinz Egypt has contributed to the modernisation of tomato cultivation in Egypt by creating new forms of cooperation between manufacturers and farmers, and by introducing new seed varieties for industrial purposes.

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