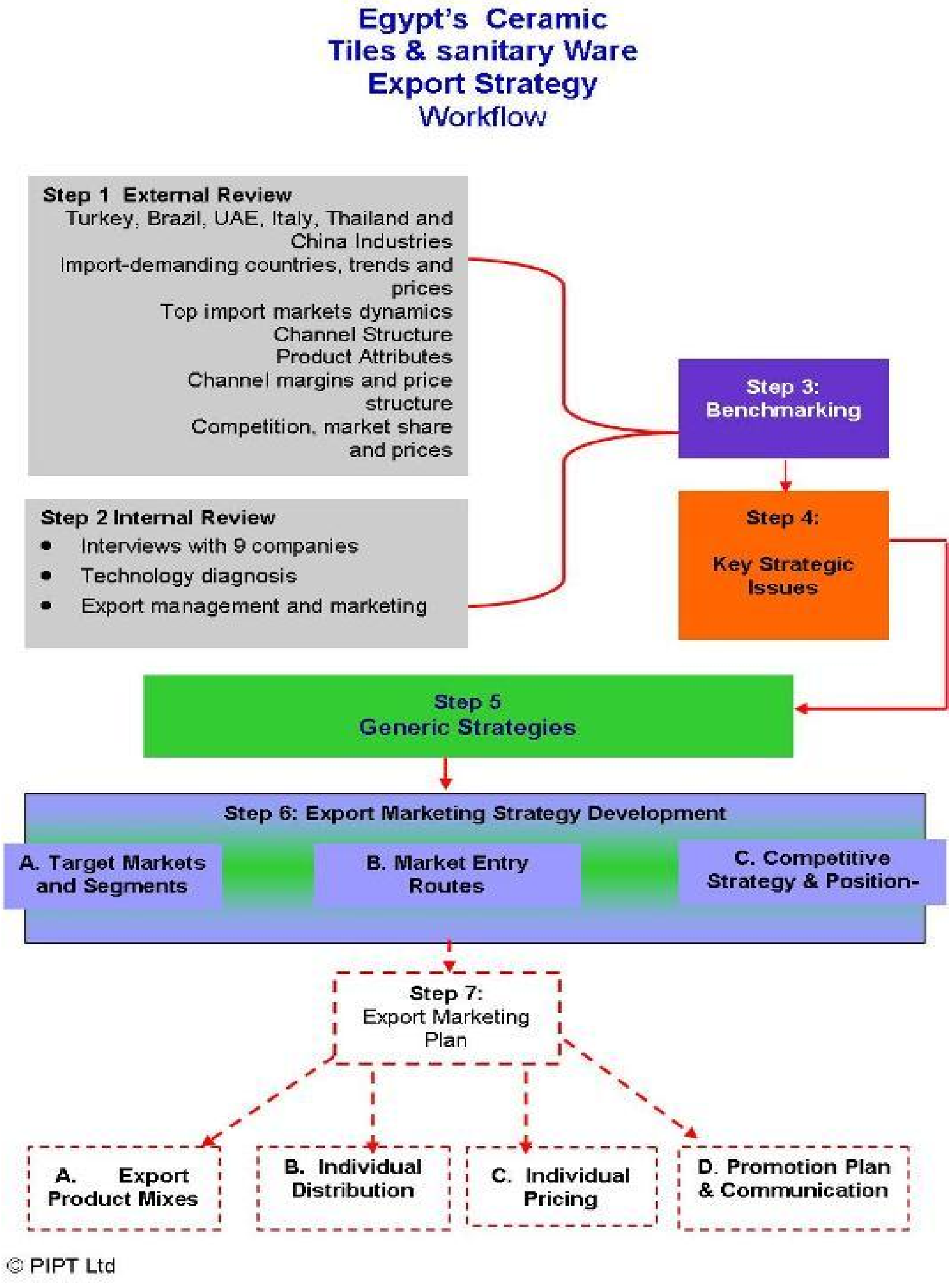
EXECUTIVE SUMMARY

P I P T

EXPORT STRATEGY
FOR
EGYPT'S CERAMIC
TILES & SANITARY WARE
INDUSTRY

SEPTEMBER 2006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SITUATION SUMMARY

MANUFACTURING

Dealing first with the Egyptian tile sector, we note that it is expanding significantly but in the context of a world over supply situation.

This Egyptian growth is primarily due to its major competitive advantages of low energy prices and very competitive labour costs, enabling its manufacturers to compete comfortably in the low-medium end of the market using low selling prices but in some cases at low profit margins.

However Egypt has a perceived quality and image problem among tile buyers internationally in spite of its manufacturing traditions and production heritage going back 50 years or so.

Many international buyers prefer to purchase tiles from relatively new manufacturing countries such as Brazil, Turkey and Thailand that are on average higher in price but are also perceived to be of higher quality.

With cost pressures being experienced in Turkey in particular, primarily through rising energy prices and labour cost, there is an opportunity for Egypt to develop a competitive stance.

This should be viewed in the context of a global trend in favour of improvement of overall product quality from both consumers and suppliers.

This perception is strongly supported by these above mentioned countries' own quality improvements and, very importantly, their "quality" promotional platforms.

To overcome this problem a few Egyptian manufacturers are attempting to build their own brands both within Egypt and abroad and in some cases are being successful. This should be viewed in the context of an imminent WTO instigated "Trade Liberalisation" ruling which will have the effect of opening up the local Egypt market to foreign imports.

Notwithstanding this the overall "country brand" of Egypt is still weak.

Productivity in Egypt is in fact low and process losses are high in comparison to international norms, contributing to the overall lower quality level of the industry. Furthermore a combination of poor staff training and inherently high levels of overstaffing contribute to the loss of opportunity for higher utilization of production capacity.

There is also little evidence of demand side knowledge and developed relationships with international buyers in general within the Egyptian industry.

The proportion of porcelain tile made in Egypt is low but the world trend is for a significant change in favour of porcelain floor tiles. This is particularly reflected in the porcelain production replacing over half of the ceramic tiles production in Italy and from the demand side countries such as the United States and Japan are shifting towards porcelain tiles. Hence a structural change in Egypt's tile production is called for in order to have access to a new global demand sector as well as to boost the perceived image and value of tiles exported from Egypt with a product, such as porcelain, that stands for higher quality.

All tile companies are importing their glaze frit and colour materials at high costs, as there is only one, small and not particularly reliable local source for glaze. A couple of companies are planning to manufacture their own frit, but in general there is an opportunity for FDI in this area to serve the whole sector.

The Egyptian tile industry can develop its export capabilities by improving its product quality and quality image.

These improvements can be achieved by in-plant technical assistance programmes and the establishment of an Association for the industry. The Association would also co-ordinate and oversee the vocational and technical training requirements of the industry and certification at a designated institute. This industry representation would then also encourage more FDI into the sector, which currently has negligible foreign investments.

The Egyptian sanitary ware industry is structurally quite different to the tile sector, in that FDI is long-standing with global sanitary ware companies involved with three Egyptian organisations, one being fully foreign-owned. These globally linked companies all have strong exports led by well-known brand names to target the high and medium-end of the market.

The other local sanitary ware companies produce for the low-medium end of the market in both Egypt and mainly for other Middle-Eastern countries.

There is also a general problem with high process wastage and low quality production, as in the tile industry. Some companies are less worried about lower rates of First Choice production, finding sufficient demand in the local market that is able to absorb Second Choice products. The ready acceptance of the market for second-grade products means that there is less incentive for the manufacturers to improve general quality levels.

In addition the very low labour costs and energy costs in Egypt[1] also result in sanitary ware companies being reluctant to invest in semi or fully automatic casting systems, because of perceived low levels of ROI.

We have noted that current planned investments and production expansions are therefore designed only for manual casting systems, which inherently have higher wastage and lower quality, due to the manual handling of the products. China, though possessing similar energy and labour cost advantages as Egypt, is upgrading its factories and shifting to fully automated production to achieve economies of scale and higher quality levels at the same time.

The proposed vocational and training institute for the ceramics and sanitary ware industries will benefit the improvement of the skills base of these industries, leading to an upgrading of both productivity and quality of the products.

EXPORT MARKETING

Egypt is a relatively small tile and sanitary ware exporting country whose selling proposition has to date been based on a cost/price platform. With competition increasing through global over capacity, new strategies need to be developed to grow exports.

PIPT has developed a production/costs/quality versus target market/price segmentation matrix.

The Companies in both the sanitary ware and ceramic tile sectors have been classified into Category A companies and Category B companies.

This categorisation is based on audits carried out by the Consultants in terms of export readiness from a combination of production, technical and export management perspectives.

Given each category's analysed level of competitiveness, a comparison of performance against the benchmarking countries has been drawn up and export marketing strategies developed for each category.

The export marketing strategy puts forward recommendations on primary and secondary target markets and product/price segments together with the most appropriate entry routes/distribution

[1] ***It is worth noting that the cost data obtained from Egyptian companies was found to be inaccurate in most cases, as the companies perceived this information too sensitive to share in detail. PIPT consultants' team has though made allowance for inaccuracies in analysing data and the strategy development.***

channels.

The Ceramic Tile sector's Category “A” companies are recommended to target exports to more sophisticated markets. These markets have more and better developed competition so PIPT proposals are based on high organisational effectiveness, continuous improvement of product quality and high export marketing skills that handle market research, plan the export marketing mix and follow through market development tactics.

Category “B” ceramic tile companies are advised to concentrate exports to markets that are growing in imports with a wider lower-middle segment with less rigid quality standards. These companies are advised to avoid head to head competition with the Chinese prices and to continuously work on quality improvement as one of the key means of remaining competitive over the longer-term.

In the case of Sanitary Ware, the sector's export performance is better than the ceramic tile sector, since exports are mostly concentrated in growth and the major import markets in the world. Therefore Category “A” companies are advised to strengthen their own brand positioning in existing markets and within contract/process work which historically operates at lower margins. These companies need to keep a continuous knowledge feedback from their export destinations and maintain quality and design upgrades. Brand support activities and customer relationship management skills are vital to the maintenance of continued price/margin and brand share success.

Competition with China for the Category “B” companies is intensive and in the long term un-winnable with their current product portfolio. China’s economies of scale based on their expanding home market and their moves into greater automation suggest that Egyptian manufacturers need to concentrate on product quality improvements, more accurate mid market targeting and greater sophistication in export marketing techniques.

In general most Exporters are advised to concentrate on increasing penetration and share in promising growth markets rather than pursuing a policy of opening up new markets, thereby concentrating scarce and precious resources in areas of highest return.

Egypt’s Glazed Ceramic Tiles

Egyptian exporters are concentrating their exports in markets that are generally importing less. This can be compared with most of the benchmarking countries export performances focusing on developing those large markets that are also showing considerable import growth.

Nevertheless the well developed connections, good will and trust that the Companies have created in their existing export markets are factors that cannot be dismissed.

The companies that continue to export at below Chinese prices and cater to the absolute low-end segment in their export destinations, are threatened by higher quality, similar priced products coming from China in the near future.

This is due to the Chinese already upgrading their factories, increasing their capacities and producing in areas in China that have the lowest labour and energy costs, hence it is predicted that there will be considerably tougher competition in the low-end markets.

Egyptian manufacturers taking this approach need to start upgrading quality, their facilities and finding an edge in increased labour and production efficiency paired with higher improved export marketing skills.

There needs to be a process of selection of agents, rather than response to an agent's request of representation in a certain country.

Greater product support services in the market are needed with a focus on increasing market share in existing markets, rather than the continuous striving to open new markets, especially when the Companies' overall export quantities are not, in comparison to other countries, high enough to make a serious impact.

The whole export marketing mix of export price, export product mix, entry route and promotional support in the export market should be aimed at an improvement of the product image and away from the sole Unique Selling Proposition of "price" only.

Egypt's Ceramic Sanitary Ware

Egyptian Sanitary Ware companies vary considerably in their export performance, efficiencies and orientations. In the case of two Companies they do not fully control their choice of export destinations since they are within the control of European brand manufacturers. These companies will not be the concern of this study, but will be referred to in later sections of these recommendations.

The majority of Egyptian exports are dedicated to the ***'healthier'*** export destinations, i.e. top importing countries and high growth countries. Also the Egyptian export prices are in the same range, or slightly below their Turkish and Brazilian competitors.

The possibility of the same Chinese low cost scenario, as mentioned above in the tile sector, developing in this market segment is a very real concern.

There was a general reluctance in the industry to switch to more automated production even when most of the companies visited had future expansion plans. The inexpensive labour and low energy costs do not justify for the Beneficiaries, from a short-term perspective, the capital investment in more sophisticated equipment. Though from a cost perspective (as can be evidenced from the benchmarking section) the longer term cost savings and quality improvements encourage a shift away from manual production.

Another supporting argument is China's realisation of the same fact by heavily modernising their factories, despite the same short term cost advantages of cheap labour and low energy costs.

A continuous shift from the Arab/Middle East countries to higher value, larger and greater importing countries is recommended for all companies. Aside from the obvious top importing countries, there are a number of middle ranking countries that qualify as potential export destinations such as, Sub-Saharan countries, The Russian Federation, Greece, Poland, Sweden, Ukraine, Taiwan and Hungary.

RECOMMENDATIONS

PIPT has developed export strategies for the Egyptian Ceramic Tile and Sanitary Ware Sectors tailored to these sector's different profiles and needs. Companies within each sector were grouped in two categories, given their levels of export readiness, and two strategies were developed in each sector and recommendations were put forward addressing the following strategic export marketing decisions:

- Recommended Target markets and segments
- Recommended Market Entry Routes
- Recommended Competitive strategy, positioning and pricing

The proposed Export Marketing Strategies are established in broad terms where each company will need to fit and narrow it down to meet its own corporate objectives. Each company will need to customise its own export marketing strategy and plan activities that address the implementation of its export marketing mix per selected target country, i.e.:

- Export Product mix (per export market), packaging and labelling
- Export Distribution mix (per export market)
- Export Price list (per export market)
- Export Promotion and communication per export market i.e. the mix of Tradeshows, Trade Missions, promotional material, presentations & representation and Public Relations.

Our recommendations aim for an improvement of the 'Made in Egypt' Ceramic Tiles and Sanitary Ware product and image at all levels, aiming at a longer-term better global quality positioning of all 'Made in Egypt' ceramic products.

In order for the companies to be able to implement their export marketing strategies, several sector improvement programmes at the macro level have been discussed and recommended in this paper.

These Generic sector development programmes will include the setting up of a Trade Association, proposals for FDI, training, design, a quality platform, a country branding and new product introductions through the development of porcelain production.

All these proposals will directly impact on the quality of Egypt's product, its perceived value to the importing markets and furthermore will provide support and enhance the competitiveness of all Producers.

Positioned between EU and Asia, Egypt's economic strengths are in its large, relatively inexpensive workforce, its well-educated middle classes, its natural resources, its low cost energy, its proximity to opportunity markets and the G of E's commitment to export growth.

Foreign trade has been identified as the engine of economic growth, yet Egypt's economy functions on two separate tracks across most industries.

On the fast track, businesses have adopted international best practices and new technologies, boosting productivity;

On the slow track, traditional businesses operate at productivity rates that are less than half of average global best practices.

As Egypt implements various reform, investment and liberalisation programmes to achieve sustainable growth and focus on increasing exports, its industries face increasing challenges in the world trade markets.

Based on the Ceramic industry's needs to counter global competitive trends, protect its local industry and expand its exports, Egypt should consider re-positioning its current ceramics offer to foreign buyers:

- Egypt needs to establish that an overall positioning of "Made in Egypt" offers superior benefits, i.e. consistent **quality**, versus the newly established country marques, e.g. Thailand, Turkey and Brazil.
- Egypt needs to promote the **value** it offers to all buyers and specifically those in outsourcing, i.e. proximity to market and fast turnaround, versus cheaper competitive alternatives, e.g. China.
- Egypt needs to develop manufacturers' **brand** collections i.e. value added propositions, to compete with European and South East Asian brands, e.g. ROCA, Duravit, Vitra, RAK and Cementhai.

The re-positioning objectives listed above should be considered and followed in sequence, moving from generic to company specific over time. For example it would prove much less difficult, expensive and time consuming to develop an Egyptian brand if there were international "value" and "quality" perceptions previously established about the country manqué.

These major repositioning objectives can be achieved through a three-pronged strategy:

- To establish a credible **quality** platform for Egyptian manufacturers internationally via the development of a "Ceramics Association".

  The Companies need to concentrate on improving all elements of quality in terms of:

  - Management, organisation structure and training;
  - Manufacturing, costs of production and staffing levels;
  - Product finish, First Choice and design;
  - Marketing, sales and negotiations;

Subject to quality changes and improvements, the Association can then support these established standards through accreditation and certification and then promote and publicise these internationally.

The targeting of these quality messages would initially be concentrated at the key decision makers, at the "buyer" level, and subsequently developed to encompass end users.

- To proactively demonstrate **value**, speed of turnaround/delivery and flexibility of production targeting the development of new contacts, alliances and partnerships to supply tiles and sanitary ware products to foreign buyers plus outward processing and contract work.

New forms of co-operation between individual elements of the supply chain have now been developed, usually at the initiative of the bigger buying organisations that have the muscle to insist on their adoption and can take the lead in supply chain management. This is now key because over the last few years the supply chain has changed dramatically and, depending on the industry, it could now account for nearly 70% of the cost structure, including inventory, warehousing and transportation.

These include strategies such as "Just-In-Time" and "Quick Response".

Bill Ramsey, VP of Six Sigma and operations director at Honeywell adds, "I need people with a strong understanding across a broad skill set of what makes a supply chain tick; so experience in buying, planning, manufacturing, marketing and delivering is crucial; it's really no longer about the supply chain, it's now about the integrated supply chain."

In addition new manufacturing and distribution strategies are being developed to ensure an acceptable supply to the end user; this will include specialised systems for manufacturing, particularly in small batches and even direct distribution to the end user. Furthermore this exposure to the latest foreign techniques and best practices should allow for significant knowledge transfer within manufacturing, SCM, distribution, product development, CAD, marketing and sales negotiation.

This supply side progression is often viewed as being a crucial stage in the development of an indigenous self-standing industry.

- To create Beneficiary collections with corporate **branding**.

It is well established that long-term profits come at the upper end of the ceramics value chain, concentrated in “original brand manufacturing”, OBM and “original design manufacturing”, ODM.

In this sector brand equity value, made up of both generic (country of origin) and specific to the branded manufacturer account for a significant proportion of value added.

This development coupled with greater knowledge of end user needs, designs, price points and the products routes to market by opportunity country, should enable Companies to concentrate their resources and achieve maximum Return on Investment.

Based on the benchmarking exercises, international analyses and the consultants’ extensive experience in ceramics and export marketing, PIPT have developed a series of strategic recommendations referencing the specific requirements of both:

- The Egyptian Ceramic Industry as a whole.
- The current Beneficiary Companies