ENTERPRISE PARTNERS
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Facilitating Inclusive Growth in Ethiopia

Think Systemically, Act Strategically, Adjust Frequently for Best Results
Enterprise Partners Programme, 2013-2020

Enterprise Partners

September 2020

Facilitating Inclusive Growth in Ethiopia

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ENTERPRISE PARTNERS

making markets work for all

2013-2020

Enterprise Partners

EP was established in 2013, funded by the United Kingdom's Foreign, Commonwealth and Development Office (formerly the Department for International Development), to facilitate market systems development in order to create jobs and raise incomes of Ethiopians, especially women, living in poverty. The primary focus was to stimulate agro-industrial growth and access to finance, with the objective to leverage over GBP 300 million in additional investment and sales, create 45,000 jobs, increase the income of 65,000 people, and support 150,000 people to access financial services. EP had to achieve these results in a specific context: where there were very few MSD programmes and at a time when the Government of Ethiopia was only just beginning to embrace the private sector as a development partner who could support the pursuit of the country's industry-focused, export-led growth goals.

Enterprise Partners Case Study Series

Enterprise Partners released a series of case studies in November 2020 to share the progress, lessons and insights of the programme's seven years of market systems development in Ethiopia. This case study forms part of that series.

Case Study Compendium: Insights and Lessons for Driving Market Systems Change for Inclusive Growth in Ethiopia

Enterprise Partners Programme | 2013-2020

1

Case Study 1

(Synthesis Paper)

Facilitating Inclusive Growth in Ethiopia:

Think Systemically, Act Strategically, Adjust Frequently for Best Results, Enterprise Partners Programme, 2013-2020

2

Case Study 2

Enterprise Partners in Support of Industrial Transformation:

Building an Industrial Labour Services Market in Ethiopia

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Case Study 3

Adaptive Management: from the Inside Looking Out:

Managing the Enterprise Partners Market Systems Development Programme in Ethiopia

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Case Study 4

Transforming Financial Service Markets for Micro, Small and Medium Enterprises (MSMEs) in Ethiopia through Direct Technical Assistance to Financial Institutions:

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Enterprise Partners' Monitoring and Results Measurement system and DCED experience

The case study compendium and standalone studies can be downloaded at **https://enterprisepartners.org**

Acknowledgements

Enterprise Partners (EP) is a programme commissioned by the Foreign, Commonwealth and Development Office (FCDO) and implemented by DAI Global UK with the consortium partners - First Consult, ITAD, and Enclude - between 2013 and 2020. Authors of the case study series collaborated closely with the EP team to present findings and learnings of the seven years of the programme.

This case study is authored by Marshall Bear, a Market Systems Development Consultant, and William Grant, the DAI Senior Principal Development Specialist for Market Systems Development. The case study was made possible with the contribution and collaboration of the following EP team members: Linda Yohannes, Strategic Communications Lead, and Nebil Kellow, Team Leader.

The authors would also like to thank all of the stakeholders who shared their time and perspectives to enable the development of this synthesis case study, especially the authors from the other case studies whose findings formed the foundation of this synthesis analysis.

Review, editorial support and design services were provided by the firm EngagingDev.

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Acronyms

DBE	Development Bank of Ethiopia
DFID	Department for International Development
EIB	European Investment Bank
EIC	Ethiopian Investment Commission
EP	Enterprise Partners
FDI	Foreign Direct Investment
FOREX	Foreign exchange
CGFC	Capital Goods Financing Company
GBP	British pound
GDP	Gross domestic product
GoE	Government of Ethiopia
GTP	Growth and Transformation Plan
MOA	Ministry of Agriculture
MFI	Microfinance institutions
MOI	Ministry of Industry
MSD	Market systems development
MSE	Micro and small enterprises
MSME	Micro, small and medium enterprises
MT	Megatonne
NPL	Non-performing loans
PEPE	Private Enterprise Programme Ethiopia
PFI	Private financial institution
SME	Small and medium enterprises
SMEFP	Small and Medium Enterprise Finance Project
TA	Technical assistance
USD	US dollar
WEDP	Women's Enterprise Development Project

Foreword

The Government of Ethiopia (GoE) formed an ambitious vision of export-led agro-industry growth and charted two Growth and Transformation Plans (GTP I and II) to accelerate Ethiopia's movement along a pathway to middle-income country status by 2025. The United Kingdom's Foreign, Commonwealth and Development Office (formerly the Department for International Development – DFID) provided support to the GoE to help translate its economic growth vision and plans into practical action through its Private Enterprise Programme Ethiopia (PEPE) - a seven-year (2013-2020), GBP 70 million aid investment.

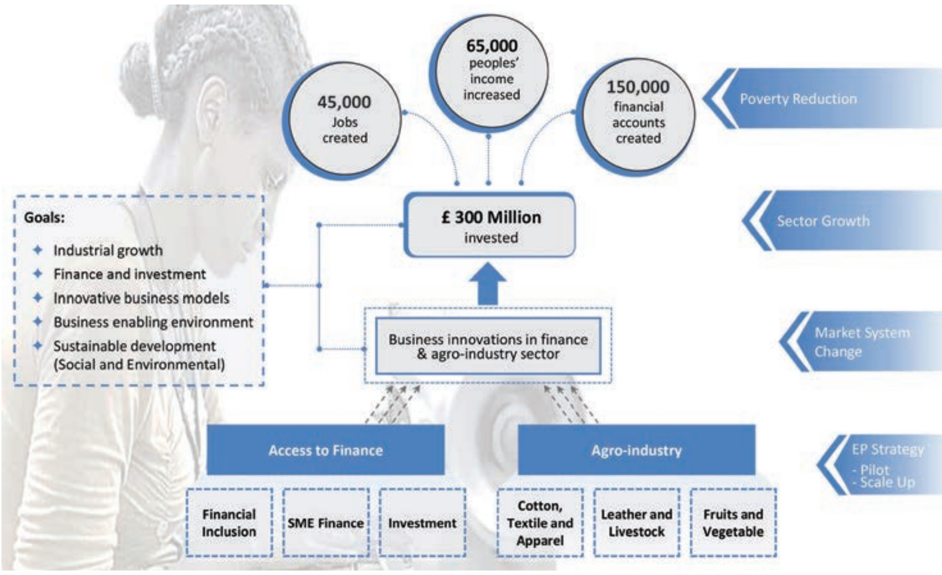
Enterprise Partners (EP), a GBP 43 million component of PEPE, would focus on strengthening the role of the private sector as a development partner to the GoE. This supported the GoE's goal as stated in GTP I and GTP II – 'The role of the private sector in driving sustained growth, and creating jobs is indispensable.'[1] DFID appointed DAI Global UK Ltd as the managing contractor for EP and a market systems development (MSD) approach was adopted to advance export-led growth[2] and increase access to financial services[3] for small-scale productive and women-owned enterprises. EP also supported the delivery of more than USD 320 million in lines of credit from the World Bank and the European Investment Bank (EIB).

EP's mandate was in line with the priority sectors identified in the GTP II (2016-2020), including the textiles and garments, leather shoes and leather products and horticulture sectors as well as industrial zone development. EP was requested to focus on these sectors in their totality given their upstream development potential. The targets were set to leverage over GBP 300 million in additional investment and sales, create 45,000 jobs, increase the incomes of 65,000 people, and support 150,000 people to access financial services (refer Figure 1). EP's challenge was to achieve these objectives in a very specific context: a developmental state pursuing a development strategy that was more akin to those of China or Vietnam than anything on the African continent.

Over seven years EP directly engaged in a number of priority agro-industry and financial services sub-sectors and multiple market systems within these sub-sectors. EP interventions and its allocation of programme resources were designed to leverage more private sector – and complementary public sector – investments in priority sectors which, if effectively targeted, would result in more sales and better practices through inclusive business innovations. These market outcomes would in turn lead to the creation of more jobs and increased income.

Figure 1 EP Theory of Change

ENTERPRISE PARTNERS is a market facilitator initiative established to facilitate **agro-industrial growth** and enable **access to finance** in Ethiopia. This will result in job and income opportunities for poor people, particularly women.



[1] GTP II, p. 19.

[2] EP's sector/sub-sector engagements included: cotton, textile, apparel; livestock and leather; and fruit and vegetables

[3] Financial services included savings, loans, payments/remittances, insurance and leasing

Introduction

Five separate case studies are synthesised in this paper:

1. **Enterprise Partners in Support of Industrial Transformation: Building an Industrial Labour Services Market in Ethiopia** – describes EP's support to Ethiopia's nascent garment sector through the creation of a labour services market for industrial workers.

2. **Adaptive Management: from the Inside Looking Out: Managing the Enterprise Partners Market Systems Development Programme in Ethiopia** – describes changes made by EP inside its organisation to improve its effectiveness in facilitating better performing and more inclusive markets.

3. **Transforming Financial Service Markets for Micro, Small and Medium Enterprises (MSMEs) in Ethiopia through Direct Technical Assistance to Financial Institutions: The Case of Enterprise Partners** – describes EP's support to unblocking barriers to financial services for MSMEs.

4. **Journeys to Impact: Charting New Pathways from Pilot to Scale for Market Systems Transformation in Ethiopia** - describes how EP adapted its interventions in response to market system dynamics while staying focused on achieving desired market outcomes and impact.

5. **Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions** – describes EP's support to policy reform in the cotton and leather sub-sectors using a stakeholder-driven, evidence-based process of policy formulation.

This compilation of five case studies tells a compelling story of market system transformation at a time when the GoE was just beginning to embrace the private sector as a development partner to achieve the country's agro-industry, export-led growth goals. The case studies present the perspectives of EP staff and key public and private sector stakeholders within EP's sub-sectors of engagement as they reflect on the journeys taken and accomplishments realised as a result of EP's seven years of operational experience. This synthesis paper distils lessons from all five cases into a coherent whole so that the intended audiences – governments, donors and managing contractors of private sector development programmes – can benefit from EP's reflections on its journey as an MSD programme.

As a pioneer in taking an MSD approach to support Ethiopia's inclusive growth, EP wanted to share its experience through these case studies for the following reasons:

1 The context of Ethiopia's state-led development paradigm set it apart from other MSD programmes in Africa and created a unique niche for these case studies in the private sector development and MSD literature.

2 Lessons from EP's experience in facilitating market system transformation for competitive and inclusive growth in one policy context can shed light on what has become a more open political and liberal economic context adapted by the new government when it came to power in 2018.

Structure

This paper has been structured as follows:

1 Part 1 Background

Sets out, at some length, the economic and market system context which dramatically influenced EP's strategies, actions, successes and failures as an MSD programme. It discusses EP's role and its use of the MSD approach to translate the GoE's ambitious vision and plans into results. The reader will learn of the challenges EP faced when fostering growth in the agro-industry and financial services sectors in the nascent stage of their lifecycles, and when confronting unforeseen distortions on market incentives caused by GoE policies. This backdrop is important to understand and assess EP's overall accomplishments.

2 Part 2 Results

Discusses the results (up to 2020) of targeted agro-industry and financial services sub-sectors and EP's contributions to these results. The reader will learn that EP exceeded end-of-project expectations in some measures of impact and market outcomes while falling short in others to varying degrees. EP was most successful in fostering growth in Ethiopia's nascent garment sector by creating a labour services market from scratch for industrial workers capable of supplying garment factories in industrial parks with entry-level workers at scale. EP also succeeded in improving MSME access to financial services – lending, leasing and private equity – with its biggest success evident in the linking of financial institutions and their customers to World Bank credit lines, initially valued at USD 50 million, but expanded to USD 420 million after a successful proof of concept. Readers will also learn the many reasons why EP fell short in helping the government to meet the GTP-related impact and outcome targets in the cotton, leather and horticulture sub-sectors but still made significant progress in policy reform and scalable business modelling to position these sub-sectors for growth within a more enabling policy environment.

3 Part 3 Adaptive Management

Examines this topic from two perspectives. The first perspective looks inside the market system to foster sustained pro-poor outcomes through purposeful experimentation, development and scale-up. The reader will be taken on multiple journeys of discovery along different pathways to impact and scale with many twists and turns along the way.[4] The second perspective is from the inside of EP looking out to the market system and discusses EP's own journey of continuous learning from experience and adapting its organisation – staff, systems, structure – so that it could cost-effectively exercise its role as a catalyst and influencer of market system transformation.

4 Part 4 Insights and Lessons

Draws insight and lessons from EP's experience deemed useful for stakeholders of Ethiopia's growth policies and plans and MSD practitioners, especially those working in thin and/or weak market settings.

[4] Yilma, T. Tessema, W. and Grant, W. (2020), *Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions*, Enterprise Partners

Part 1:
Background

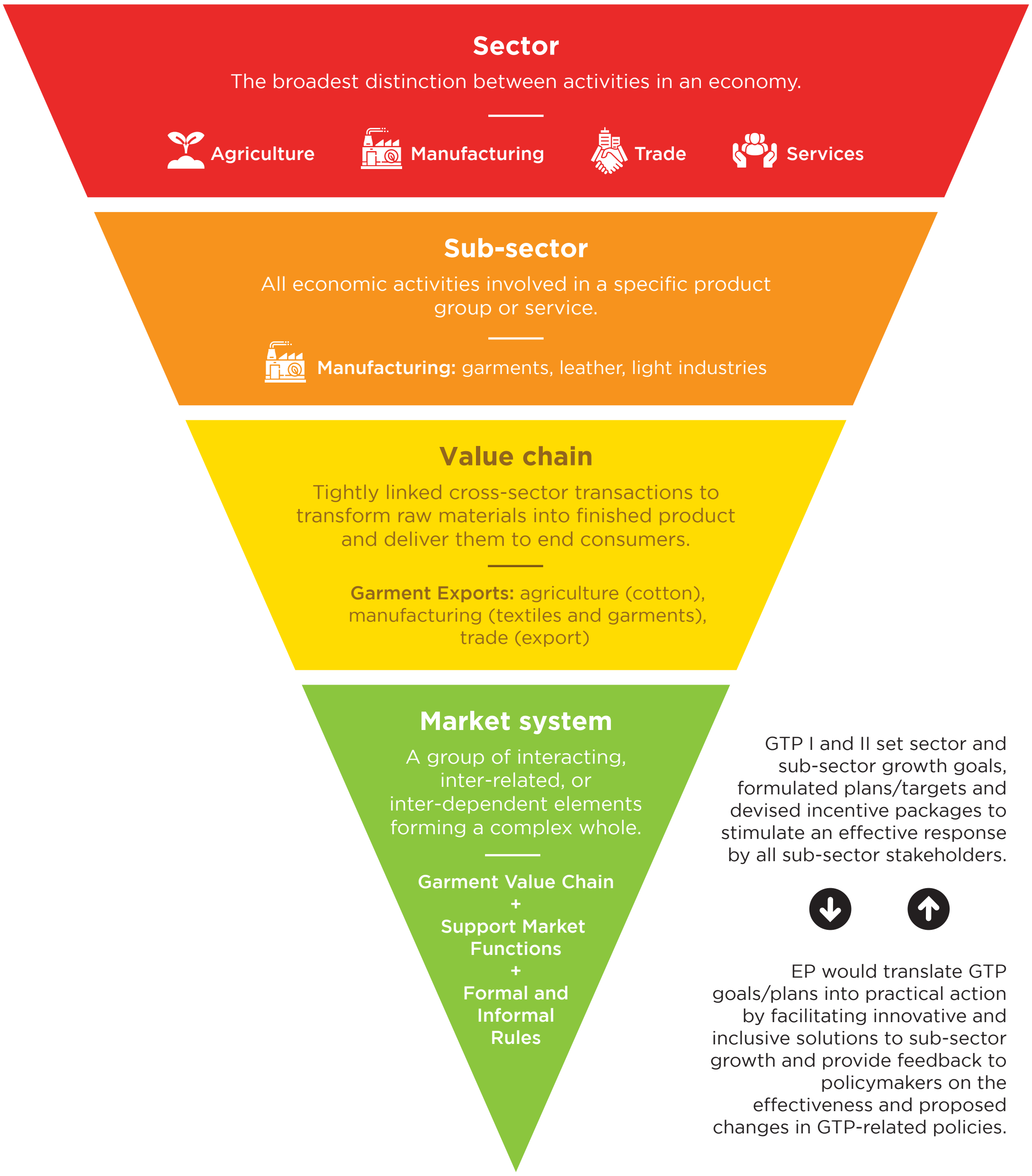
GoE's Growth and Transformation Plans I and II[5]

Definitions of different forms of economic organisation sets the stage for understanding the role EP played in translating the GoE's growth vision and plans into practical action. Figure 2 presents important definitional distinctions between sector, sub-sector, value chain and market system. The definitions are presented in the form of an inverted triangle to show the narrowing of economic organisation from sector (e.g. industry) at its broadest to market system (e.g. labour in garment exports) at its narrowest.[6] The GoE set ambitious growth plans/targets at the sector and sub-sector level by projecting future growth based on past GDP and sector performance. Priority economic sectors were chosen based on how policymakers saw Ethiopia's comparative advantages in using its resource endowments of land, labour, water, livestock and climatic conditions. Plans and targets were set to capture as much value-added as possible by deploying these resources in export-led agro-industry sectors while also devising incentive packages to stimulate foreign direct investment (FDI) in these sectors. Export-led growth would augment Ethiopia's woefully inadequate reserves of foreign exchange which in turn could be used for re-investment to meet GTP I and II growth goals.

[5] Ethiopia's Agriculture Development Led Industrialization policy pre-dated and under-pinned GTP I and II. For more information visit: https://www.grips.ac.jp/forum/af-growth/support_ethiopia/document/Jun09_ADLI_2.pdf

[6] The firm – the narrowest form of economic organisation – would have been added if EP was designed as enterprise support programme

Figure 2 Definitions of economic organisation



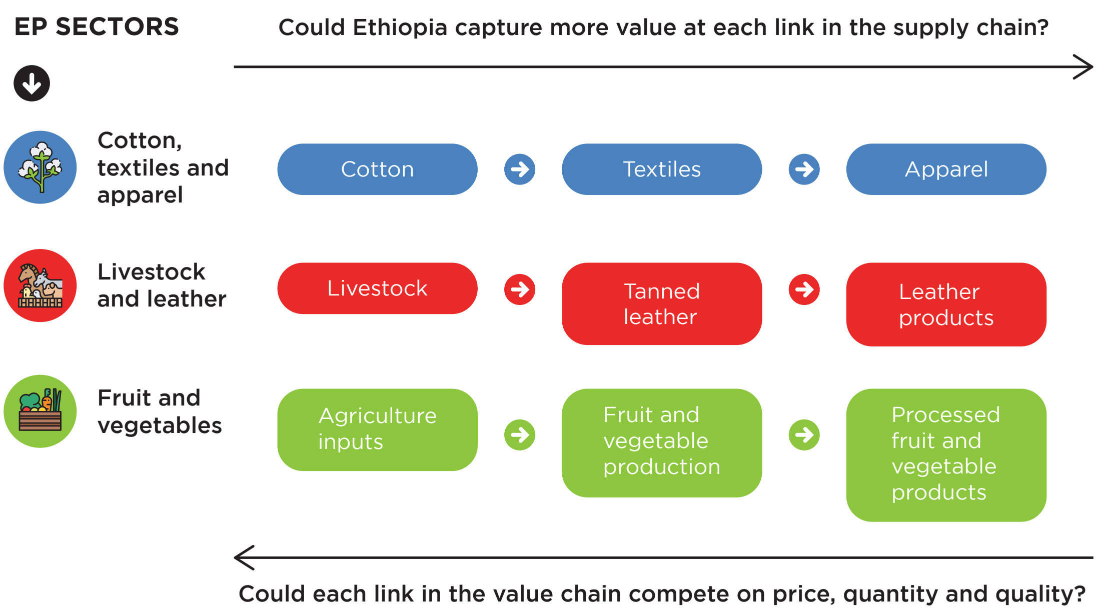
The GoE wished, for example, to accelerate growth of the manufacturing sector through its nascent garment export sub-sector by offering a rich mix of incentives that included state of the art industrial parks, tax holidays and favourable trade agreements, to attract international brands and their factory partners to re-locate to Ethiopia. A growing garment sub-sector could take advantage of Ethiopia's large under-employed agricultural labour pool to recruit factory workers. Although Ethiopia's cotton sub-sector lagged far behind the production and export of its coffee and grain sub-sectors, the country had an abundance of land and favourable agro-climatic conditions to increase agriculture sector output, including cotton production. GoE policy makers aimed to capture value at each link in the value chain – from cotton to textiles to apparel manufacture. While this was an ambitious and laudable vision, the policy was largely un-informed by an understanding of the challenges associated with vertical integration and on-the-ground business reality. EP would continuously circle back to GoE policy makers with evidence of the challenges of vertical integration and feasible alternatives to move priority sectors along a more realistic pathway of competitive and inclusive growth. This story repeated itself across the other two agro-industry sectors in which EP was engaged. Ethiopia had the eighth largest livestock population in the world, and the second largest in Africa. The country had developed its leather industry over decades, mostly through large exports of raw or semi-processed hides and skins. Could Ethiopia develop its nascent leather products sub-sector (e.g. shoes, gloves, upholstery) and compete in international markets while also capturing more value-add from its large stock of animals? The GoE imposed a 150 percent tax on the export of semi-finished leather to encourage tanneries to better serve Ethiopia's leather product manufacturers while also capturing better returns from the export of finished leather. Did it work as intended?

Ethiopia had a comparative advantage in a number of horticulture products, particularly fruit and tomatoes, due to its favourable climate, available land, proximity to European and Middle Eastern markets, cheap farm labour, vast reserves of groundwater for irrigation and favourable land lease and water management arrangements offered by the Government.[7] However, the production of horticultural crops was much less developed than the production of food grains in the country. The agro-processing sub-sector was small with a mix of private and state-own processing facilities, all largely dependent on imported pulp and with weak links to fruit and vegetable farmers and traders. Could Ethiopia significantly expand the production of fresh fruit and vegetables to satisfy increasing domestic demand while also exporting processed fruit and vegetables to regional and international markets?

EP Translates GTP I and II into Practical Action

Where the GoE's growth vision, plans and incentives ended, EP's work began. EP conducted intensive value chain and market system research using best practice analysis and intervention planning tools to translate the GoE's agro-industry growth vision into results. EP's research aimed to answer two overarching and inter-related questions as shown in Figure 3.

Figure 3 EP translates the GTP into practical action



[7] EP April 2019, Horticulture Processing Strategy

We first look at these two overarching and other related questions for each of EP's three agro-industry sub-sectors of engagement. We then discuss the challenges EP faced to increase access to financial services by women-owned MSMEs in productive sectors of the economy.

Cotton-Textile-Apparel

Garment factories located in industrial parks needed a large pool of factory workers, estimated at 36,000 at the start of EP's engagement. Could the garment sector attract local labour at scale – mainly women from rural communities? Could it price labour costs so the industry could compete against other sources of garments in the US market under the African Growth and Opportunity Act and within Africa (notably Lesotho, Kenya, Egypt)? Garment factories consumed large quantities of cloth of different types for their apparel products. Would they be better served by textiles from Ethiopia or imported textiles? Could Ethiopia's textile factories compete against imports for a share of this market? Could local textile factories leverage their locational advantage to both local cotton farmers and traders of cotton lint to make textile factories a competitive offer against imported textiles? Could cotton farmers significantly expand production of the right variety of quality cotton at scale to satisfy garment factory specifications for textiles?

Livestock and Leather

The livestock[8] and leather value chain had the added challenge of securing FDI without the benefit of GoE investments in state-of-the-art industrial parks while concurrently upgrading local tanneries to produce quality finished leather at greater scale. Would the GoE's 150 percent export tax on semi-finished tanned leather encourage local tanneries to shift their business model from price to quality? Or would it attract more FDI tanneries/leather product manufacturers to take advantage of local skills and resources to expand exports? Could local tanneries upgrade product quality using existing machinery and know-how to meet specifications from domestic and foreign buyers of finished leather? Did the local tanneries have international connections to the end market users of the finished leather and could they meet their quality standards? Could local tanneries encourage livestock farmers to upgrade the quality of traded raw hides and skins?

[8] Raw skins and hides from goats, sheep and cattle.

Fruit and Vegetables

Ethiopia was an important horticultural exporter, led by the flower industry. Could it leverage its success in floriculture exports into the fresh fruit and vegetable sub-sectors? Could it develop an internal market for processed fruit and vegetables in Ethiopia? Past GoE efforts to kick-start its nascent agro-processing industry had met a long list of constraints: high competition from importers; long customs procedures; lack of financing; poor packaging; unreliable fresh fruit and vegetable supply; and the use of inferior processing technology. The GoE needed to find ways to substitute imports with a domestic supply of fresh and processed fruit and vegetables while also targeting regional export markets, saving FOREX on imports and generating a new source of FOREX through exports. Could Ethiopian farmers produce a wider variety of fruit and vegetables appropriate for processing with more assured access to quality seeds and knowledge of best agronomic practices? Could Ethiopia put in place an aggregation and storage system to distribute perishable products from farm to market (e.g. processors and retailers)? Could fruit and vegetable farmers and traders deliver perishable products at the required price, quality, quantity and timelines needed to encourage processors to shift from importing pulp to sourcing local fresh produce? Lastly, could processing factories leverage their local supply advantage and be competitive in both domestic and export markets?

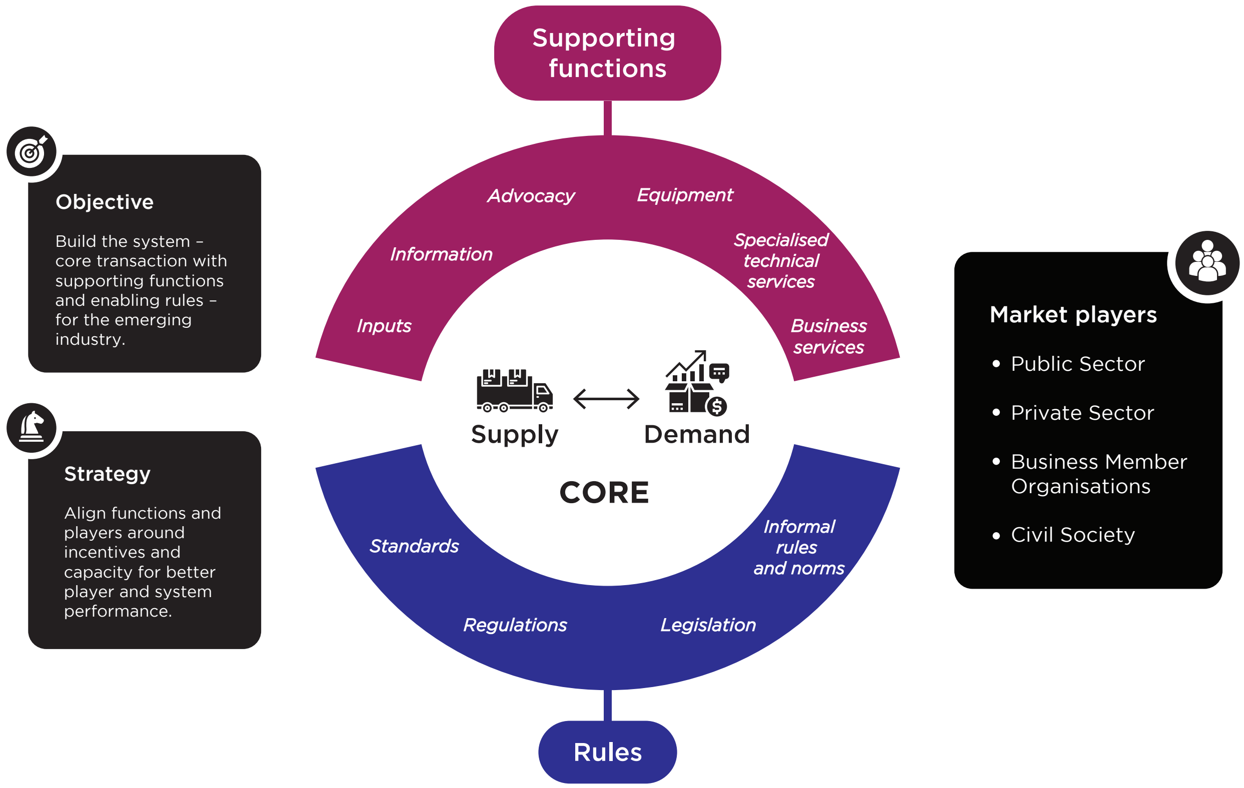
Access to Finance

Ethiopia's financial sector was not keeping up with the evolving needs of the private sector. Ethiopia's banks were financing large companies and government projects, while the micro-finance institutions (MFIs) focused on lending to the rural poor. Micro and small enterprises (MSEs), particularly women-owned MSEs and productively-oriented small to medium enterprises (SMEs), were very poorly served. Could this missing middle be reached? Could financial institutions be convinced to target these important market segments? Lending was dominated by traditional loan products – collateral-based for large businesses and small, solidarity-based loans for the rural poor. Private bank and MFI liquidity was insufficient to meet demand. Could financial institutions be convinced to adopt new, more appropriate, loan products? Could substitutes to collateral be identified? Could leasing services feasibly target small productive businesses? How could additional capital be attracted to Ethiopia? The World Bank was interested in supporting the GoE to address liquidity constraints if the banks and MFIs could effectively use the lines of credit to reach the target populations. Could private equity be attracted to meet the financial needs of fast-growing Ethiopian companies in need of patient capital? Did the Ethiopian companies know how to access private equity?

The Market Systems Development Approach

Figure 4 describes the thinking behind the approach, its objectives and its strategy as they are guided by this thinking. MSD thinking emerged around 20 years ago from the realisation that direct aid delivery to economic actors was often: a) inefficient (reaching only a few players); b) ineffective and unlikely to be sustainable once the donor funding dried up; and c) potentially harmful to local businesses (donor subsidies could crowd out commercial players with the potential to supply goods and services in the long run).

Figure 4 The market systems development approach



The objective of the MSD approach is to build a system of appropriate supporting functions (e.g. inputs, services, information and skills) and enabling rules (formal and informal) to effectively match demand and supply for goods and services in any given market context. For example, one can try to grow cotton without access to good seed, but yields are likely to be less, and the insufficient length of the cotton fibre might even prevent sales into certain markets. Without well-trained workers, the apparel industry cannot compete on the world market. Without access to appropriate technology, know-how, information and adequate laws, banking becomes costly and risky, and reduces the willingness and ability of banks to engage riskier clients.

Market systems are multi-function and multi-player – public, private, business member organisations, civil society – each with different interests but, hopefully all with a shared interest to advance the long-term socio-economic growth of the country. In emerging market systems, such as those in Ethiopia, there can be both critical gaps in market functions and/or mis-alignments between existing functions and players because of historical precedent, the absence of inputs and services to support business innovation and growth (e.g. information, equipment or specialised technical and business services) or a policy regime that is not in sync with the government's vision for growth. The strategy of an MSD programme is to create and/

or strengthen critical market system functions and facilitate the best alignment between market system functions and players to advance a country's future vision of inclusive growth. EP was tasked to find answers to the following two overarching questions in relation to the GoE's growth strategy:

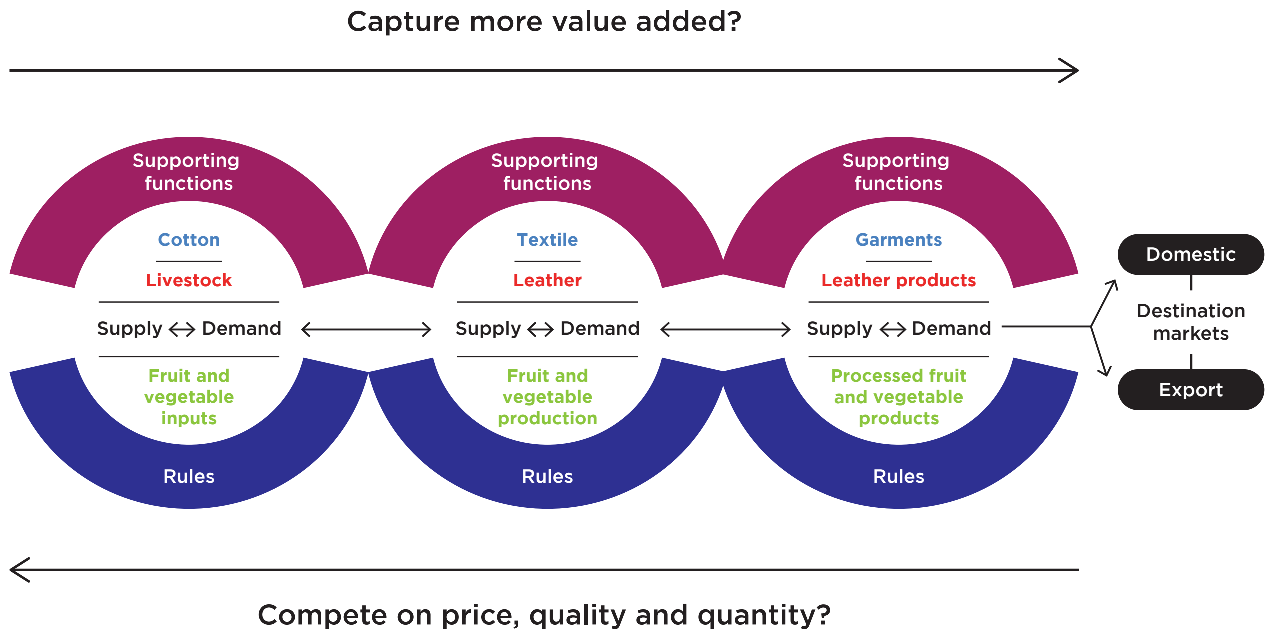
1. Could Ethiopia feasibly capture more value-added through export-led growth by having an integrated industry from raw materials to finished product exports?

2. Could each link in the value chain compete on price, quality and quantity to make them thrive?

Answers to the questions could only be revealed by assessing the market system structure and dynamics at each stage in the chain of value-added (refer Figure 5). EP invested in upfront analysis in order to identify points in these inter-connected market systems where it could effectively and feasibly deploy its resources to stimulate a process of market system transformation in support of Ethiopia's growth goals. The details of these assessments are captured in the separate case studies on EP's experience in the garments, cotton, leather and financial services sub-sectors. These case studies present the many elements that were considered while applying a market systems development approach to competitive and sustained inclusive growth against the backdrop of Ethiopia's development state economic context, including:

- The challenge of overcoming inherent conflict in value chain relationships (e.g. buy low/ sell high)
- Unforeseen yet evident distortions on market incentives driven by an urgent need to build reserves for foreign exchange
- Policies formulated to accelerate value capture from Ethiopia's resource endowments that were inadequately grounded in business reality and an understanding of how economic systems function
- Institutional arrangements within government and between government and the private sector that were dictated more by the political economy than market transformation considerations
- Ethiopia's insularity from the outside world and its effect on smart and strategic choices on FDI plans and partners
- Donor prerogatives strongly influenced by GoE partners versus broader stakeholder interests for longer term and more durable change.

Figure 5 Agro-industry value chains comprised of multiple market systems



Part 2:
Results

With about 109 million people (2018), Ethiopia is the second most populous nation in Africa after Nigeria, and the fastest growing economy in the region. It is also one of the poorest, with a per capita income of USD 790.[9]

Ethiopia's economy experienced strong, broad-based growth averaging 9.9 percent a year from 2007-2008 to 2017-2018, compared to a regional average of 5.4 percent. Ethiopia's real GDP growth dropped to 7.7 percent in 2017-2018 but was forecasted to increase to 8.5 percent for the fiscal year ending in July 2019.[10] Industry, mainly construction, and services accounted for most of the growth. Agriculture and manufacturing made a lower contribution to growth in 2017-2018 compared to the previous year.

Higher economic growth brought positive trends in poverty reduction in both urban and rural areas. The share of the population living below the national poverty line decreased from 30 percent in 2011 to 24 percent in 2016. Major challenges remained, including:

- Limited competitiveness, which constrained the development of manufacturing, the creation of jobs and the increase of exports
- An under-developed private sector, which limited the country's trade competitiveness and resilience to shocks
- Political disruption associated with social unrest could negatively impact growth through lower foreign direct investment, tourism and exports.

Enterprise Partners End of Programme Impact/ Outcomes against Targets

DAI Global UK Ltd, the managing contractor of EP, was contracted by DFID to stimulate agro-industrial growth and access to finance, with the objective to leverage GBP 300 million in additional investment and sales, create 45,000 jobs, increase the income of 65,000 people, and support 150,000 people to access financial services. Table 1 shows the actual versus planned impact and outcome results, assembled from data gathered and reported in EP's DCED-audited MRM system.[11]

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[9] https://www.worldbank.org/en/country/ethiopia/overview

[10] IMF Economic Outlook

[11] Enterprise Partners (2020), *Enterprise Partners Results Measurement and Experience with the DCED Standard*

Table 1 End of programme impact and outcomes

	End Line Targets	Actual
Impact		
Jobs	45,000 people	48,861 supported
Increased Income	65,000 people	28,292
Outcomes		
Sales	GBP 55 million	29.5 million
Firms Changing Practices	245 firms	143
Investments	GBP 285 million	294.7 million
Access to Financial Services	150,000 accounts	105,878

The data shows that EP exceeded expectations in some measures of impact and market outcomes while falling short in others to varying degrees. The previous background section helps the reader understand the bigger picture context that either enabled or reduced EP's ability to meet its impact/outcome targets set at the start of the programme and which remained largely unchanged throughout the seven years. Jobs supported was close to achieving its target, a balancing out of jobs gained in garments but lost in leather. The increase in income was mainly designed to come from agricultural interventions, particularly within horticulture and cotton. This materialised accordingly; more than 17,000 smallholder farmers were reached through horticulture seedling interventions, and more than 11,000 in cotton seed multiplication and cotton contract farming, resulting in increase in their incomes by 20 percent or more, meeting 44 percent of the target.

EP's over achievement on stimulating new investments reflected positively on the GoE's success in attracting FDI with a package of incentives, developed with EP's contribution, to encourage continued investment based on a track record of investment returns. This over achievement in new investments also underscores EP's role in removing critical constraints to accessing finance for an estimated 16,800 borrowers, yet another indicator where EP surpassed end line targets. The World Bank's credit would have been vastly under-utilised had EP not directly engaged by building the capacity of MFIs to take advantage of it. EP's access to finance interventions also targeted the opening of new bank accounts by people who were previously excluded from the financial system. Interventions to introduce a tiered Know Your Client system in one of the private banks and the expansion of mobile and agent banking in Gambella Region, one of the most marginalised regions in the country, significantly enhanced access to finance for close to 100,000 financially excluded people.

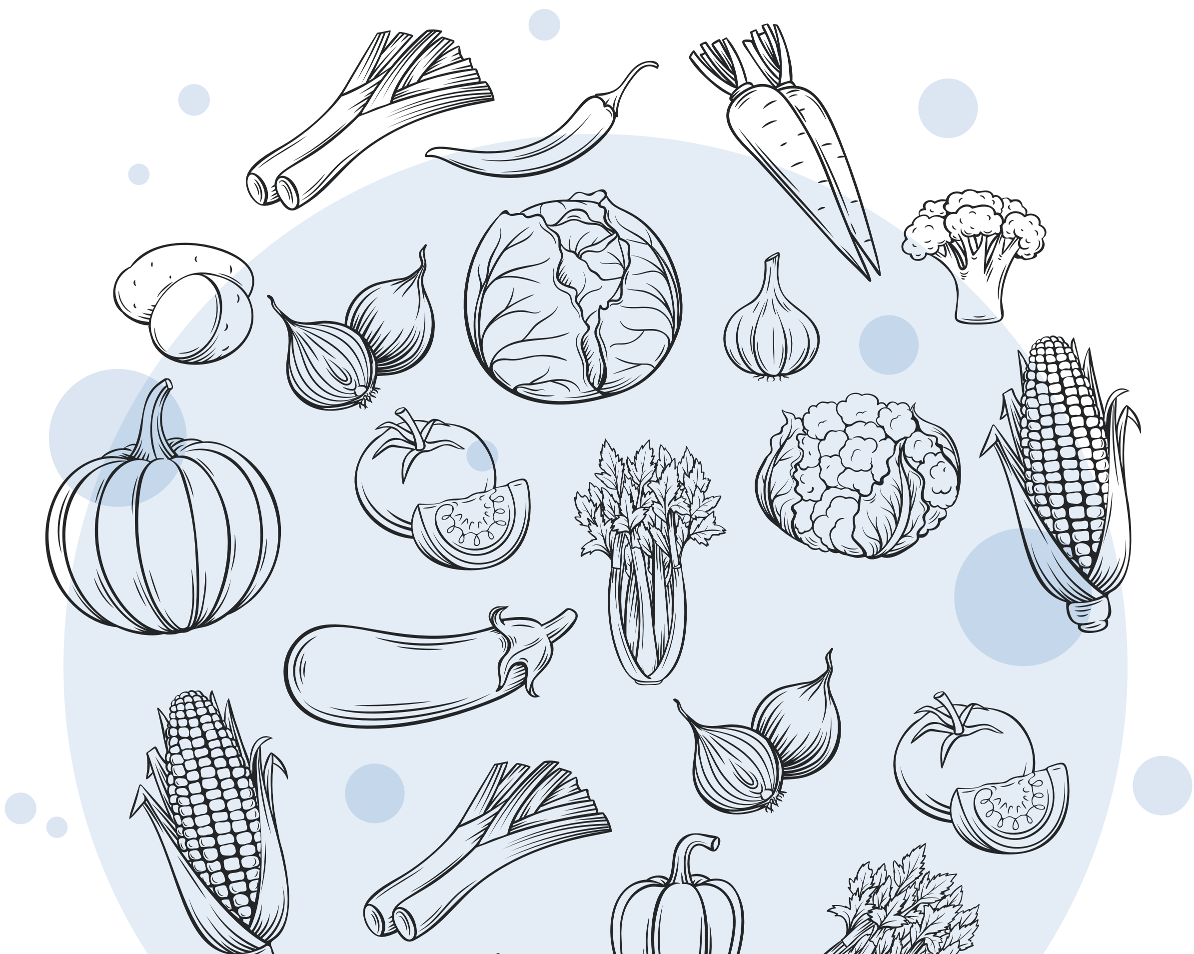
According to EP's data, it fell short in stimulating more sales in priority sub-sectors. However, export sales in garments skyrocketed during this period and one could argue that EP's work in putting in place an effective labour market system contributed to this sales increase. Leather sales declined across the board and fruit and vegetable exports largely stagnated for reasons identified in the previous section. EP reported 143 firms changed business practices against an end line target of 245 which reflects, perhaps, the readiness of firms to continuously innovate even when the rewards for doing so may be deferred until the business policy environment improves.

Agro-Industry Export-Led Growth

Seven years has passed since EP began in 2013. What have been the results in the agro-industry and financial services subsectors where EP focused its interventions? EP's contribution to export-led growth can only be understood and appreciated when assessed against the growth of priority sectors throughout this seven-year period.

The GoE wanted to emulate a growth model where the country captured more value at each link in the supply chain through agro-industry exports in higher value market segments. Garment sector exports skyrocketed during this period albeit in low-value market segments as might be expected for an industry in the nascent stage of its lifecycle. Ethiopia's labour market responded by supplying the industry with workers for entry level jobs at the scale required and with gradually improved labour productivity and retention. Seven years back the labour market response was pitifully low and slow.

The GoE's vision had fallen far short of its ambition in cotton, leather, fruit and vegetables. While the stories of these sub-sectors cannot be told with bold headline impacts on job and income increases, the progress made was more nuanced and can be measured in terms of better functioning market systems – policies becoming aligned with business reality and improved agriculture inputs – poised to tap Ethiopia's yet unrealised growth potential in these subsectors. What follows is a summary of priority sub-sector growth as of 2020, followed by EP's contributions to this change.



Cotton, Textiles and Apparel[12]

Cotton

In 2020, raw cotton production levels did not reflect the cotton sub-sector's potential, nor did they satisfy the growing textile and garment industry's potential demand. The country produced on average 47,000 tonnes of lint cotton (used by spinning mills) between 2013-2020, while the domestic demand for lint cotton from the fast-growing textile sector hovered around 100,000 tonnes of lint cotton.

The textile industry required longer and finer fibre cotton to make better yarn whereas the varieties planted by cotton farmers were mainly short fibre with unacceptable levels of contamination and uniformity. Most ginners continued to use saw versus roller gins which aggravated the level of seed cotton contamination due to poor ginning practices.

A disabling GoE policy environment (a start/stop ban on cotton exports followed by onerous export licensing procedures) and unfavourable institutional arrangements (the Ministry of Agriculture was side-lined when the Ministry of Industry was appointed as the cotton, textiles and apparel value chain lead) contributed to disappointing levels of cotton production against GTP II targets (1.8 million MT). The reality of the global buyer-led textile and garment industry was that economic benefits were lopsided; the value accrued towards the downstream actors in the value chain, which did not incentivise farmers to produce more cotton unless market system improvements were made in the core, support and rules functions.

While the growth potential of a more competitive cotton sub-sector remained a work in progress, an improved cotton market system, facilitated in large part by EP's interventions, put the cotton sub-sector on a pathway to becoming more competitive and investment friendly. An estimated 20,000 commercial and smallholder cotton growers gained access to better cotton seed – still a big gap between coverage and need – with a reported 30 percent increase in productivity.

Textiles/Apparel

Ethiopian apparel exports (knits and woven products) skyrocketed from USD 61 million in 2014 to USD 294 million in 2019[13] despite many challenges – factory efficiency, cycle time and delivery lags[14] – associated with a nascent and emerging modern textile/apparel export sector. Ethiopia's emerging garment sector benefited from multiple GoE incentives, including the creation of state of the art industrial parks, tax benefits and favourable trade agreements. Buyers and their manufacturing partners took advantage of these incentives and began investing in factories located in the parks.[15] Initially, Ethiopia's large pool of available labour did not respond to the factories' increased need for labour to fill entry level jobs, notably due to perceived low wages and a reluctance to pursue industry-based work located in novel urban environments.

Jobseekers, particularly women, have since responded to job openings due in large part to the creation of a labour services market system which could effectively source, screen, grade and place new recruits into entry level factory jobs. EP played a major role in facilitating the creation of Ethiopia's industrial worker segment in the labour market. By 2020, more than 30,000 workers had been recruited by 32 factories in three industrial parks[16] with the capacity to expand and/or navigate major disruptions (e.g. COVID-19) because the institutional arrangements within the GoE and between the GoE and the private sector coalesced around a successful public/private sector model of cooperation. Farm workers with an agriculture background began to self-identify as industrial workers with the support and encouragement of their families. This deeper systemic change will benefit the industry as it moves from the nascent to growth stage of its lifecycle.

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[12] Yilma, T. Tessema, W. and Grant, W. (2020), *Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions*, Enterprise Partners

[13] Global Trade Atlas, August 2020

[14] https://www.allianceexperts.com/en/knowledge/countries/africa/trends-in-the-textile-industry-in-ethiopia/

[15] DevLearn (2020), *Journeys to Impact: Charting New Pathways from Pilot to Scale for Market Systems Transformation in Ethiopia*, Enterprise Partners

[16] The model EP has put in place is being copied by other industrial parks in coordination with the GoE, but EP did not count those results, even though they came from an EP-initiated model

Leather and Livestock[17]

Ethiopia's leather sector performed poorly during this period. Major declines in exports of finished leather offset increases in exports of leather products (especially shoes from FDI). Some local tanneries closed, while others were treading water at the time of writing and only a few of the strongest local tanneries were thriving. Domestic firms exporting finished leather lost market share to FDI factories who did not, as anticipated, lift the sector in global markets by transferring new knowledge and technology to Ethiopia. Declines in leather production and sales also negatively disrupted relationships between tanneries and suppliers of raw skins and hides.

Both exogenous and internal factors contributed to the leather sector's disappointing results. Over the past 20 years, there had been a steady decline in global demand for leather due to an increasing preference for synthetic materials. At the same time, production costs increased due to environmental and social compliance pressures. The demands from leather goods manufacturers exceeded the ability of tanneries to respond. Ethiopia is currently poorly positioned to enter and grow in this segment.

In 2012, the GoE imposed a 150 percent export tax on semi-finished leather to force tanneries to produce finished leather for Ethiopia's leather goods exports sector (footwear, gloves etc.) and for export to end manufacturers, capturing greater value-add in Ethiopia. It was thought this policy would cause only a temporary disruption as occurred when the GoE imposed a 150 percent export tax on wet blue/crust leather in 2008 to encourage tanneries to switch to semi-finished tanned leather and create more value-add. It did not!

The 150 percent export tax caused a major disruption in the tannery sector because the skill, inputs and market links required for finished leather far surpassed the capacity of local tanneries to respond. The GoE was slow to recognise that its 'sink or swim' export tax regulation was not working and only when presented with evidence of the leather's sub-sector decline did it act.

There has been one bright spot in the recent history of Ethiopia's leather sector. In 2019, the GoE adopted a new leather sector roadmap which promised to turn the sector around as it was created with evidence and the direct participation of all leather sector stakeholders. EP played an instrumental role in facilitating the development of the roadmap and associated policy formulation process, ranging from advocating for the policy re-think through to implementation and adoption.

[17] Yilma, T. Tessema, W. and Grant, W. (2020), *Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions*, Enterprise Partners

Fruit and Vegetables

The GoE's vision, ambition and rich mix of incentives (e.g. tax holidays, land allocation, loan facilities and duty free imports) and plans to capture more value from the export of fresh and processed fruit and vegetables collided once again with the reality of trying to push an infant industry into its growth stage in a short period of 10 years.

Almost 95 percent of horticulture was grown by smallholder farmers with an average of 0.5 hectares in production. Yields were far below accepted standards due to limited use of improved seeds, fertilisers and pesticides and only six percent of cultivated land was irrigated. The average value of fruit and vegetable exports amounted to around USD 0.40 per kg, with little or no increase between 2012 and 2019.[18] Export of low value crops to neighbouring countries (Djibouti, Somalia) dominated. Exports to high value markets (Middle East, European Union, United Kingdom) were gradually emerging, valued at USD 307 million in 2017-2018. Floriculture contributed 79 percent while vegetables, fruit and herbs contributed a 21 percent share of export revenue.[19]

Although local consumption of fresh fruit, estimated at about seven kg per person, was among the lowest in Africa,[20] Ethiopians' appetite for packaged fruit juices was projected to grow from 8,000 tonnes in 2012 to 13,000 tonnes in 2022. Yet Ethiopian processors had captured less than one percent in market share and relied primarily on the import of expensive concentrates.[21] The fruit and vegetable processing market was very thin, dominated by two large state-owned companies with around 20 small scale processors (owned by farmer cooperatives and private investors) in operation at any given point in time.

The promise of expanding fruit and vegetable exports and substituting imports for domestic supply (e.g. juices and tomato paste) could only be met through a restructuring of farm output designed to satisfy the needs of destination markets. This shift in product/market mix while also increasing output and yields would be an incremental process given the many system-wide constraints which ranged from inappropriate inputs, lack of knowledge of best agronomic practices and an absence of enforceable grades and standards. The GoE embarked, through its Agriculture Transformation Agency, on a multi-year, multi-donor project to create an innovative market-led multi-sector seed system. EP made a modest contribution to a more liberalised seed market by testing business models for the multiplication and commercial distribution of a mix of horticulture seedlings targeting small holders.

EP found it difficult to get much traction in moving the sector towards the GoE's ambitious vision and goals due, in part, to political unrest in Oromia, the province with the best fruit and vegetable production potential, and the huge investment/know-how required by the sub-sector to create a production base for the raw materials that would be needed at the scale required. Restrictive seed policies retarded uptake in local fruit and vegetable production. In 2018, EP wound down its interventions in horticulture processing due to low sub-sector momentum. It decided to re-engage when the GoE instructed its Institute of Food and Beverage to work closely with EP to develop new intervention ideas focused on investment facilitation, commercial fruit and vegetable production and upgrading the processing of fruit and vegetable products for domestic and export markets. A promising opportunity to expand fruit and vegetable production in the Raya Valley emerged too late in the project for EP to take it forward

[18] EP Horticulture Market Strategy, April 2019.

[19] Data provided by the Ethiopian Horticulture Exporter Producer Association, staff reporter, Further Africa, May 13, 2020.

[20] Ethiopia Fresh Fruit Market Update, GAIN Report # ET1827, 9-21-2018.

[21] EP Horticulture Processing Market Strategy, April 2019.

Increased Access to Finance

Ethiopia's financial sector was under-developed with the state controlling most financial services through state-owned banks and state-owned MFIs. Limited liquidity in the banking sector caused banks to ration funds and focus lending on the most profitable segments and customers who could meet the bank's collateral requirements, which could be two to three times greater than the value of a loan. The banking sector's product/market mix was stifled by collateral-based lending with large unmet demand by MSMEs in productive sectors of the economy. Banks did not have the skills, liquidity or incentives to develop new cashflow-based loan products which could address this unmet demand. There was not a dynamic set of skilled service providers able to support the financial sector to adopt new products and approaches which could address the under-served MSMEs. Banking laws did not allow international banks to operate in retail finance in Ethiopia, slowing the transfer of international best practices into the banking sector. With the World Bank bringing the liquidity through lines of credit to the DBE, EP introduced new cashflow-based lending products and built the capacity of financial institutions to adopt them, which increased lending to under-served segments and increased profitability.

With leasing only starting in 2014 in Ethiopia, it was a nascent market system with few transactions and very weak capacity. The market had been dominated by the Development Bank of Ethiopia's (DBE) leasing department, which accounted for 90 percent of the market in Ethiopia, with five government-owned regional Capital Goods Financing Companies (CGFC) absorbing the rest EP trained the DBE in good leasing management tools, and greatly improved their performance..

Small to medium fast-growing enterprises were not able to access longer term patient capital from private equity which could support their growth more effectively than debt financing. There was not a culture of seeking equity finance, nor the services needed to prepare for and conclude the equity investments. EP introduced a fund to stimulate private firms to seek private equity investment and incentivise them to seek business advisory support to prepare for the investments.

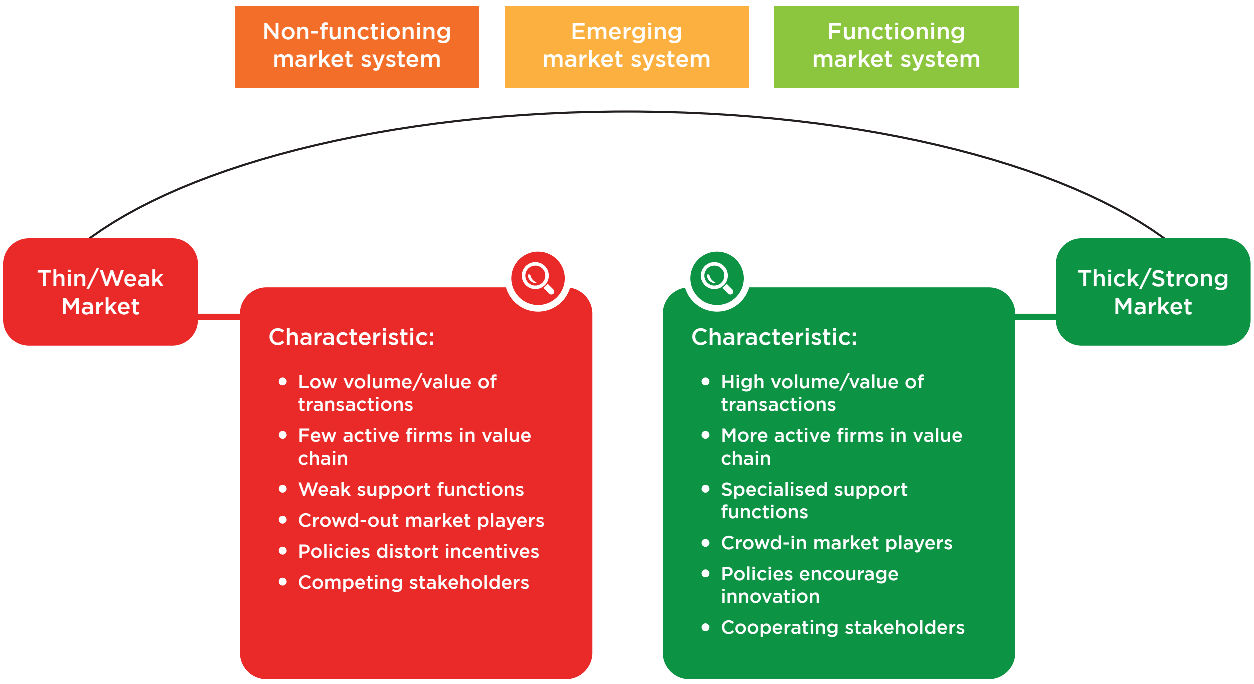
When Ethiopia invested in building industrial parks, it needed to fill them with investors. The Ethiopian Investment Commission (EIC) was tasked with targeting and attracting FDI but did not have the systems and human capacity to handle the greatly increased workload. As a government agency it was bound by the limitations of the civil service, and existing staff were not properly skilled for investment promotion. EP introduced initiatives to build the internal systems and procedures, improving targeting and aftercare, while providing surge capacity at the EIC to expand investment.

EP’s Contribution to Market System Change in Priority Sectors

Characteristics of Market System Transformation

Figure 6 presents a number of characteristics used to distinguish the relative strength or weakness of a market system along a continuum from a thin/weak to a thick/strong market context.

Figure 6 Market system change continuum



Thick/strong markets are characterised by a high volume and value of transactions, often segmented by market leaders and surrounded by niche market followers. As demand grows and differentiates along both price and quality dimensions, more firms are likely to compete for market share which, in turn, encourages a crowding-in of firms performing specialised market system functions (e.g. finance, ICT, consultants). An enabling policy/regulatory environment encourages more investment in innovation while also encouraging a high degree of stakeholder cooperation to take advantage of opportunities and counter competitive and other threats to market growth. When these characteristics are present, they tend to correlate with an effectively functioning market system.

Thin/weak markets are characterised by a low volume of transactions with few active firms who are often beneficiaries of a policy environment which does not enable competition and innovation. Low demand discourages critical support to enter the market compared with alternatives. Public and private sector stakeholder interests are mis-aligned, creating competition between stakeholders where cooperation is vital to market system growth. When these characteristics are present, they tend to correlate with a non-functioning market system.

Figure 7 plots the status of four agro-industry market systems where EP focused its interventions by looking backward from 2020 to 2013 (when EP's operations began). The figure shows that agro-industry market systems moved in a positive direction from a thin/weak market in essentially non-functioning market systems to better functioning market systems with associated increases in the volume and value of transactions. Tanned leather is the notable exception. It went from an emerging market system to a mostly non-functioning system when the GoE forced the tanned leather industry to shift from semi-finished to finished leather faster than was practically possible.

Figure 7 EP-supported agro-industry market systems on the continuum

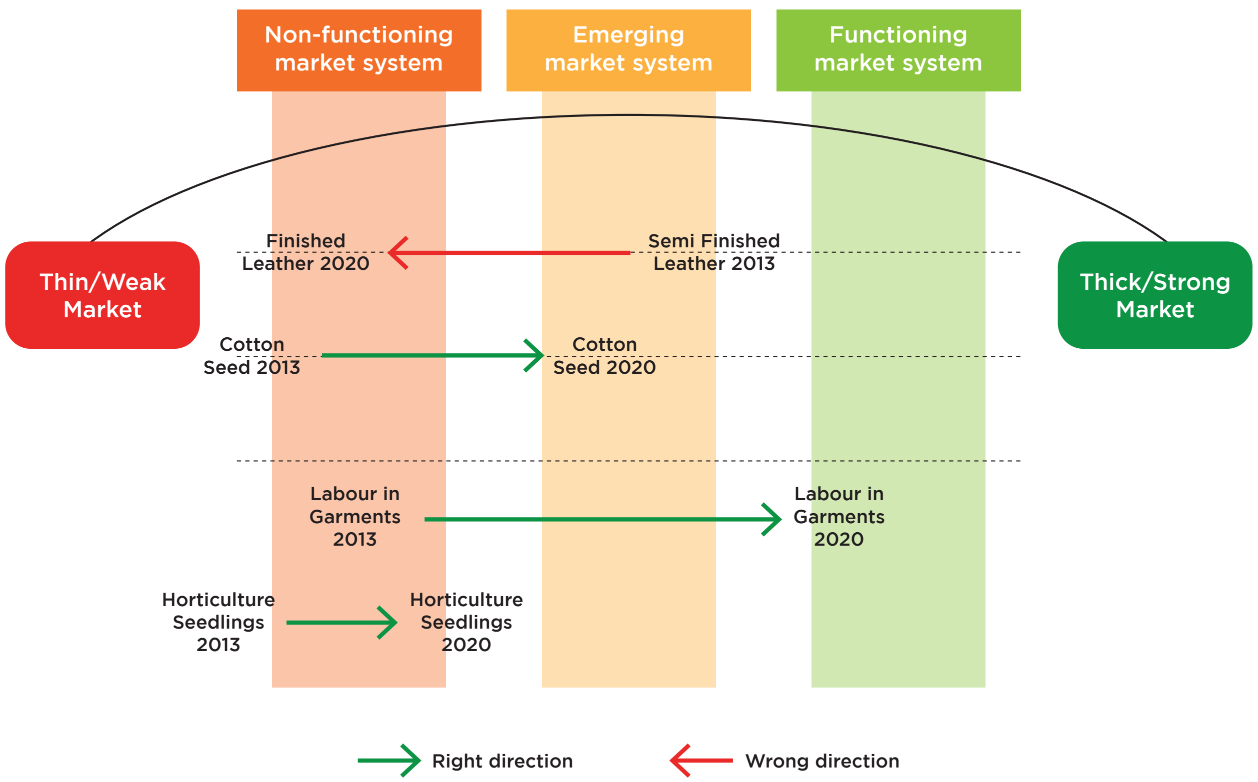
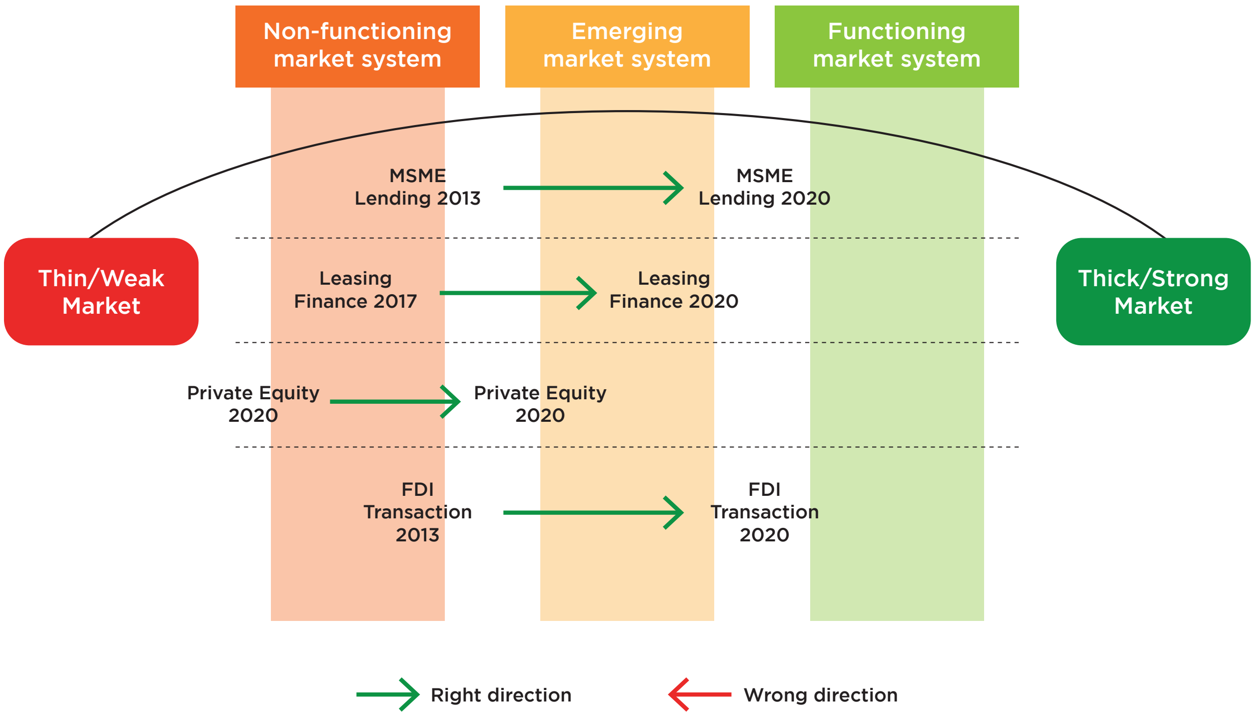


Figure 8 plots the direction along the continuum of the four financial services where EP focused its interventions. MSME lending and FDI transactions began in 2013, lease financing began in 2017 and support to private equity markets began in 2020. The figure shows that the market system for MSME lending was closest to becoming a fully functioning system.

Figure 8 EP-supported finance and investment market systems on the continuum



EP's Contributions to Market System Transformation

Priority Agro-Industry Subsectors

Table 2 summarises EP's contribution to the transformation of targeted market systems within priority agro-industry sub-sectors. The information is distilled from the different case studies on EP's experience.

Table 2 EP's contribution to agro-industry market systems transformation

Market system	Characteristics		
	Weak	**Emerging**	**Strong**
Labour in garments		• Labour supply gaps narrowing • Improvements in HR systems needed to boost labour productivity and retention	• Institutional arrangements coalesced around public-private partnership model of cooperation • All garment factories in industrial parks participate in labour market system • Transparent/fair rules for sourcing, grading and allocating workers to factories • Crowing-in of specialised training and financial service providers • Geographic spread to two regions beyond Hawassa
Cotton seed	• Large gap remains between seed coverage and need	• Institutional arrangements coalescing around adoption of new cotton sector strategy (implementation underway) • Six different cotton seed varieties available • Seven MOA licensed seed and 13 ARC seed multiplication companies • Contract farming model with textile buyer • Introduction of identity cotton market	

Market system	Characteristics		
	Weak	**Emerging**	**Strong**
Finished leather	• Domestic firms lose market share • Many domestic tanneries closed • Jobs lost not compensated by jobs gained in FDI tanneries • FDI technology transfer not apparent • Disrupted trade relationships between tanneries and raw hide and skins suppliers	• Institutional arrangements coalescing around leather sector roadmap (implementation just starting) • Importer agent model succeeds in organising tannery output against buyer specifications	
Horticulture seedlings	• Large gap between coverage and demand • National fruit and vegetable output/ productivity stagnates • Unclear institutional arrangements with GoE on seed policy	• Demonstration of smallholder farmer demand • Evidence of smallholder farmer output/ productivity increases • Viable, scalable commercial business model through local propagators	

Labour in Garments

The institutional arrangements within government and between the GoE and the private sector coalesced around an effectively functioning public/private sector model of cooperation. This model of cooperation succeeded at Hawassa Industrial Park and was replicated to industrial parks in Mekelle and Kombolcha. EP played an instrumental role in facilitating this cooperation model as each party experimented with the best fit between their incentives and capacities to solve the industry's labour shortage problem.[22]

A labour market for industrial workers was created from scratch and was now capable of screening, sourcing and grading workers by different skill sets and allocating them to employers, fairly and transparently. Specialised services such as saving schemes for workers and training services for factory managers contributed to improvements in labour productivity and retention. Further improvements in these areas await the adoption by factories of more robust human resources systems tailored to workers with very limited prior experience in industry work settings and culture.

[22] Bekkers, H. (2020), *Enterprise Partners in Support of Industrial Transformation: Building and Industrial Labour Services Market in Ethiopia*, Enterprise Partners.

Cotton Seed

EP's initial efforts to transform the cotton seed market system faced the stiff headwind of a disabling policy environment (e.g. a start/stop ban of cotton exports followed by an onerous export licensing process) and unfavourable institutional arrangements (e.g. the MOA was side-lined when the MOI was appointed as cotton, textiles and apparel value chain lead). After 2018, EP's engagement in cotton seed was helped when the institutional arrangements within government and between the government and the private sector coalesced around the adoption of a new cotton sector strategy. EP played an instrumental role in facilitating this policy formulation process largely because it could inform the process with lessons from its experience in trying to make the cotton sector competitive in its own right, de-linked from the exigent needs of the textile/garment sectors.

While yawning gaps in coverage versus need remained, the market system for improved cotton seed was better positioned through a mix of seed varieties, seed multiplication and distribution systems by competing seed companies to narrow the gap with time. The cotton sector was also better poised to enter the 'identity cotton' market with systems of certification and standards in place. Links between cotton farmers and textile mills were starting to emerge for the right reasons with the adoption of a contract growing scheme between smallholders and a large textile company.

Finished Leather

As noted above, the GoE wanted to accelerate the transformation of the leather sector as another source of critically needed FOREX whereas domestic tanneries believed they could only make this shift gradually given their limited know-how, production technology and links with importers. The GoE had hoped that FDI in leather would transfer technology/know-how to domestic factories, but this did not happen. The cumulative effects of the GoE's policy and the inability (and unwillingness) of domestic tanneries to adapt, sent the tanned leather market system backward from a high point in 2013 to a low point in 2017. This decline was evidenced by declining sales and lost foreign exchange earnings, closed tanneries, lost jobs not compensated by new jobs within FDI tanneries/manufacturers and disrupted trading relationships with suppliers of raw hides and skins.

EP interventions were intended to help domestic tanneries manage this dramatic shift in their business model in a context of competing stakeholder interests. EP piloted interventions with chemical sellers to advise tanneries on importer product specifications and with marketing intermediaries to help organise tannery work-flow, technical know-how and output to meet buyer specifications. The market intermediary model had the most success in improving sales of finished leather and both pilots provided useful models of market system upgrading once stakeholder came together to adopt the Leather Sector Roadmap.

EP played an instrumental role in bringing stakeholders together in an evidence-based, participatory policy formulation process.[23] In April 2019, the government removed the restrictive export tax on semi-processed finished leather for local tanneries. While it was too soon to tell how the new leather sector roadmap would reverse the fortunes of the tanned leather sub-sector, stakeholders were now on the same page with a more realistic vision and plan for leather sector growth.

[23] Yilma, T. Tessema, W. and Grant, W. (2020), *Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions*, Enterprise Partners

Horticulture Seedlings

By 2016, floriculture exports were expanding through FDI and contributing to foreign exchange earnings. The GoE thought it could leverage growing technology and market links in flowers and significantly expand FOREX earnings through the export of fruit, vegetables and spices. It created a package of incentives to attract FDI with only very modest success (two Chinese companies).

EP took the view that the logical pathway to expanded fruit and vegetable exports (while also substituting imports of fresh and processed fruit and vegetables) would be to better service domestic demand, estimated at around USD one billion, for a large number of increasingly urbanised consumers. EP would focus on increasing small farmer output and productivity through better planting material, increased knowledge of agronomic practices and improved post-harvest handling of perishable produce. EP also believed that without adequately increasing productivity and total production of fruit and vegetable products, there would not be enough incentives for smallholder or commercial farms to consider export as a viable option in an economically significant size. DFID disagreed: a focus on smallholder farm transformation would take too long and not directly contribute to increasing FOREX earnings in the short term. Ultimately, EP resorted to pursuing both routes and decided to partner with the newly created MOI Institute of Food and Beverages to exhaust the possibilities of local processing of fruit and vegetables for the export market. In addition, EP worked with the Institute to set-up an association of food and beverage producers.

EP did not gain much traction in pursuing this pathway for a number of reasons, including:

- Most commercial fruit and vegetable farmers were located in Oromia province, the province with the greatest potential for fruit and vegetable production. Continuous political unrest in Oromia caused fruit and vegetable investors to either close or slow down their operations. In total, horticulture saw more de-investment than expansion in the last four years of the EP programme.
- Fruit and vegetable processors were dominated by local firms who were predominantly import-dependent for their raw materials. They required a significant amount of investment in technology, infrastructure and skills to produce at a large scale for import substitution or export.
- The attempt to convert one of the emerging fruit and vegetable growing clusters, Raya Valley, to target regional markets including the Middle East attracted significant interest from both Federal and Regional governments but developing the cluster would take more time and investment than was available to EP in the wind-down phase of the programme.

EP experimented with different business models for the commercial production, distribution and sale of a modest range of fruit and vegetable seedlings (e.g. onions and tomato) to determine the scalability of these models when dealing with a perishable product.[24] The model that worked best was structured around local seedling propagators who could effectively serve nearby local communities with quality seedlings which were planted by their farmer/customers on the day of arrival. Geographic expansion by a few larger propagators with either a central nursery and/or satellite nurseries proved problematic due in large part to management issues when dealing with geographically dispersed networks of market agents.

[24] DevLearn (2020), Journeys to Impact: Charting New Pathways from Pilot to Scale for Market Systems Transformation in Ethiopia, Enterprise Partners

Access to Financial Services

Table 3 summarises EP's contribution to the transformation of targeted financial services and investment market systems. The information found in the table is distilled from the different case studies on EP's experience.

Table 3 EP's contributions to access to finance market system change

Market system	Characteristics		
	Weak	**Emerging**	**Strong**
Lending to MSMEs	• Technical service for continued financial institution upgrading • Liquidity for MFIs is still a constraint	• DBE is now revolving World Bank line of credit for MSEs • 14 MFIs and seven private banks have stronger loan appraisal capacity and systems (more than 50 percent of industry) • Financial institution interest in paying for technical services increasing • MFIs are committing own resources to MSME lending • MFIs starting to develop savings portfolios to address liquidity constraint • Most banks and MFIs have dedicated unit for SME lending	• Investors adding new lines of credit to GoE USD 400 million additional funding for MSMEs • GoE policy framework is improving to support private banks and encourage cashflow based lending, recognise movable assets as collateral
Leasing to SMEs	• Very young industry (six years old) • Only one private leasing company • Regional leasing companies still weak • Low supply of imported equipment • FOREX/liquidity constraint	• DBE and leasing companies' staffing and systems capacity increasing steadily • DBE leasing structure improved by creating a dedicated unit or leasing subsidiary • DBE non-performing loans (NPL) are coming down after applying systems improvements	
FDI Transactions	• Weak staff capacity to promote industrial parks • Staffing complement needed to respond to demand/manage FDIs • Civil service salaries are not competitive to attract strong candidates	• With support of young professionals EIC able to promote and increase FDI into Ethiopia. • EIC has stronger systems and processes to attract and manage FDI so now able to play a stronger supporting service role	

Market system	Characteristics		
	Weak	Emerging	Strong
Advisory Services for Private Equity	• Market for private equity is under-developed • Low understanding and demand by growing Ethiopian businesses for private equity • Existing advisory services not targeting small growing businesses	• Increasing awareness of SGBs of PE (123 applications for private equity services, 32 approved, and five commercial deals concluded worth USD 76 million) • Private equity advisors beginning to promote PE to small growing businesses	

Lending

Working closely with the World Bank and the GoE, EP set out to transform the way that financial institutions behaved. Increasing liquidity for the private banks and MFIs in Ethiopia to service unmet demand had been a challenge. The World Bank's Women's Enterprise Development Project (WEDP) was designed to bring a USD 50 million line of credit to MFIs to service women-owned MSEs. Most MFI lending was poverty-based, focused primarily on the rural poor. They had little incentive, or capacity, to change. WEDP provided that incentive. Using access to the line of credit, WEDP introduced individual cashflow-based lending products into the MFIs, allowing them to reduce collateral requirements and serve a new previously underserved clientele: women owned MSEs. The World Bank made using the cashflow-based lending a requirement to access the line of credit, which required major changes within the financial institutions. Without local technical service infrastructure to assist the MFIs to build the internal systems needed, EP was tasked with this job. Only MFIs certified by EP could access loans from the DBE.

Bringing an excellent mix of strong international experts and qualified local staff, EP set about transforming 12 leading MFIs. The appeal of being able to access sizeable lines of credit was sufficient to incentivise the MFIs to try these new approaches. More importantly, making loans ten times the size of the previous solidarity group loans was even more profitable for the MFIs. Applying new cashflow analysis improved the quality of the loan portfolio, bringing non-performing loans (NPLs) to less than five percent and allowed the MFIs to significantly reduce their collateral requirements, opening up opportunities for even more women-owned MSEs to access capital.

Within two years, WEDP had expended the entire line of credit, a record for Ethiopia, servicing more than 15,000 women-owned MSEs (62 percent of whom were first-time borrowers). The MFIs were also spending up to 30 percent of their own capital on MSE lending, greatly increasing the dynamism in the sector. This attracted strong international visibility. WEDP was so successful that three other donors added USD 100 million in new funding (JICA, EIB, and Italy) and included more financial institutions. The DBE committed to revolving the World Bank's initial USD 50 million back into women-owned businesses, rather than into its own general resources for project finance. Therefore, EP's success attracted investment and increased the available loan funds for women-owned MSEs by USD 150 million (beyond the initial USD 50 million one-time commitment through the WEDP).

Many of the participating MFIs increased their total lending portfolio significantly based on this experience. They improved their lending efficiency and their profitability and began pursuing new ways to increase their loan capital. They also began to understand the value of hiring outside technical service providers to improve their internal operations and to invest more in training their staff.

Given the success of the WEDP and the continued shortage of lending to productivity-oriented SMEs, the World Bank and the GoE designed the Small and Medium Enterprise Finance Project (SMEFP) with the agreement that EP would manage the technical assistance (TA). SMEFP targeted SMEs in four productive sectors (manufacturing, agro-processing, tourism and construction) whose growth was limited because they could not get equipment finance as they did not have the 200-300 percent collateral normally demanded by banks. Signed in April 2017, SMEFP brought USD 270 million in new lines of credit to be used through two mechanisms to reduce collateral requirements: leasing, a very new product in Ethiopia; and cashflow-based lending (primarily for working capital) through private banks and MFIs.

As with WEDP, financial institutions needed to have their capacity built to service the SMEs and be certified by EP before they could access the lines of credit. The main goal of the TA facility under SMEFP was to build the institutional and human resource capacity of DBE and of the private financial institutions (PFIs) to effectively serve the productive SME market. MFIs were capacitated to increase their loan sizes from MSE to SME, while the private banks were being capacitated to downscale lending from medium sized firms to SMEs, both using cashflow based appraisal systems.

The direct TA successfully changed the behaviour of the PFIs but EP was aware of the ongoing need for technical support to financial institutions beyond the programme's remit. EP invested more time building the capacity of the supporting service market at the end of WEDP and under SMEFP. EP worked with the Frankfurt School of Finance and Management and the Association of Ethiopian Microfinance Institutions to establish a certification programme for consultants. In total, 18 service providers were certified, market linkages were created with MFIs and the service providers began selling training and advisory services to the financial sector.

Using a direct TA approach, in contrast to gradually building the supporting market systems, was justified given the financial sector environment in Ethiopia, its lack of access to other international expertise and the need to solve structural lending challenges within the financial institutions. The core market of bank and MFI lending to MSEs and SMEs had been transformed with a deeper understanding and adoption of new lending appraisal methodologies, increased access to liquidity and previously neglected market segments being serviced in a sustainable manner.

Leasing

The majority of the funding under SMEFP was for the equipment leasing market. The DBE's leasing department had never been properly set up with strong practices and procedures; after only three years of lease financing, their NPLs were already at 11 percent and getting worse each year. As with the PFIs, the DBE needed to be certified by EP before it could start accessing the line of credit for leasing. EP's TA helped the DBE's leasing department to transform its appraisal process, lease monitoring and greatly improve its portfolio quality. Of the 301 leases made under SMEFP, the DBE had an NPL of only 4.4 percent, meanwhile its previous portfolio of leases was at 23 percent NPL.

The leasing sector in Ethiopia is still very young, but it is evolving. In 2019, a private leasing company, Ethio-lease, was licensed to enter the market. At the time of writing, the DBE's leasing department was performing much more efficiently and the CGFCs were beginning to expand. While still emerging, this market system now had a solid foundation to build from.

FDI Promotion

EP worked with the Commissioner of the EIC to develop and introduce a young professional's development programme to attract highly trained and motivated early-stage career professionals to provide the right support to EIC to transform it to an effective, efficient and competitive investment agency. This innovative initiative was successful in contributing to core areas such as investment promotion and investment retention, all while strengthening institutional capacity.

Two cohorts of young professionals have been integrated into the EIC, with funding support from

EP and the Bill and Melinda Gates Foundation. This direct technical assistance, paid for by donors, helped revamp systems and procedures; they worked directly with 141 potential investors, leading to 131 investments totalling USD 1.5 billion.

The young professionals had a major impact on the EIC's performance and other government agencies looked to copy the model. However, there were challenges for its replication and sustainability, particularly in relation to the EIC's ability to sustain the program. The Bill and Melinda Gates Foundation therefore supported the EIC to pay the salaries of the young professionals for a further three years after initial funding ended. Meanwhile, GIZ supported the replication and scale-up of this programme at the Ministry of Trade and Industry.

Part 3:
Adaptive Management

Intervening in complex market systems comes with a warning that implementers of MSD programmes have recognised for some time now: cause and effect relationships are identifiable only in retrospect, they are unlikely to conform with prior expectations of how things work and, as a result, interventions must be flexible as outcomes may be unforeseen.[25] The recent literature of adaptive management emerged from this recognition and offers insights to MSD practitioners from two perspectives:

Looking Inside Market Systems

A close-up view inside market systems to learn how an MSD programme interacts with system functions and players to foster sustained pro-poor outcomes through purposeful experimentation, often with frequent adjustments in strategy and tactics drawn from lessons on detailed, planned and documented experiments. EP adds its experience to this subset in the MSD literature by unpacking several of its journeys of discovery in labour in garments, finished leather, horticulture seedling and SME credit markets.[26]

From Inside the Organisation Looking Out

A close-up view from inside the organisation and looking out to complex and messy market systems to learn how best to adjust the conditions within the facilitating organisation to enable an effective response to changing market system dynamics. EP contributes to the literature on organisational effectiveness by examining different crossroads in implementation where EP's organisational set-up needed to be adjusted in order to improve its performance as a facilitator of desired market system change.[27]

[25] The Cynefin Framework referenced in USAID publication, Complexity-Aware Monitoring, Version 1, July 2018

[26] DevLearn (2020), *Journeys to Impact: Charting New Pathways from Pilot to Scale for Market Systems Transformation in Ethiopia*, Enterprise Partners

[27] Yohannes, L. (2020), *Adaptive Management from the Inside Looking Out: Managing the Enterprise Partners Market Systems Development Programme in Ethiopia*, Enterprise Partners

Looking Inside Market Systems

MSD programmes are future looking. A future vision (typically five years hence) of a more competitive and inclusive market system is formulated and accompanied by a theory of how desired change is likely to unfold during this period. Implementation necessarily starts with the current market system context: essentially, the interplay between market player incentives and capacities and the rules of the game (formal and informal) that govern their relationships. The current market system dictates the nature of the market transformation process, a change process that is rarely linear but rather one that encounters many twists and turns and, in some cases, false starts.

EP, its direct partners and other sector stakeholders undertook multiple journeys of discovery to transform Ethiopia's weak or missing market systems in support of competitive and more inclusive agro-industry and financial services sub-sectors of the economy. Four journeys are summarised here because each represents a distinctive market system context in which these journeys were undertaken.

The Springfield Centre's market system matrix is used as a visual tool to illustrate the market system context at the start of each journey. The matrix was previously introduced in Part 1. Background. Definitions of key terms are repeated here to aid the reader in understanding the narrative that follows:

Core

This is the market-based transaction between sellers and buyers of goods and services. Each link in the value chain from inputs to production and production to the distribution/sale of outputs is a market system in its own right.

Support Functions

These are a range of functions delivered as either services (e.g. consulting or finance) or mechanisms (e.g. coordination or advocacy) to enable supply and demand to come together.

Rules

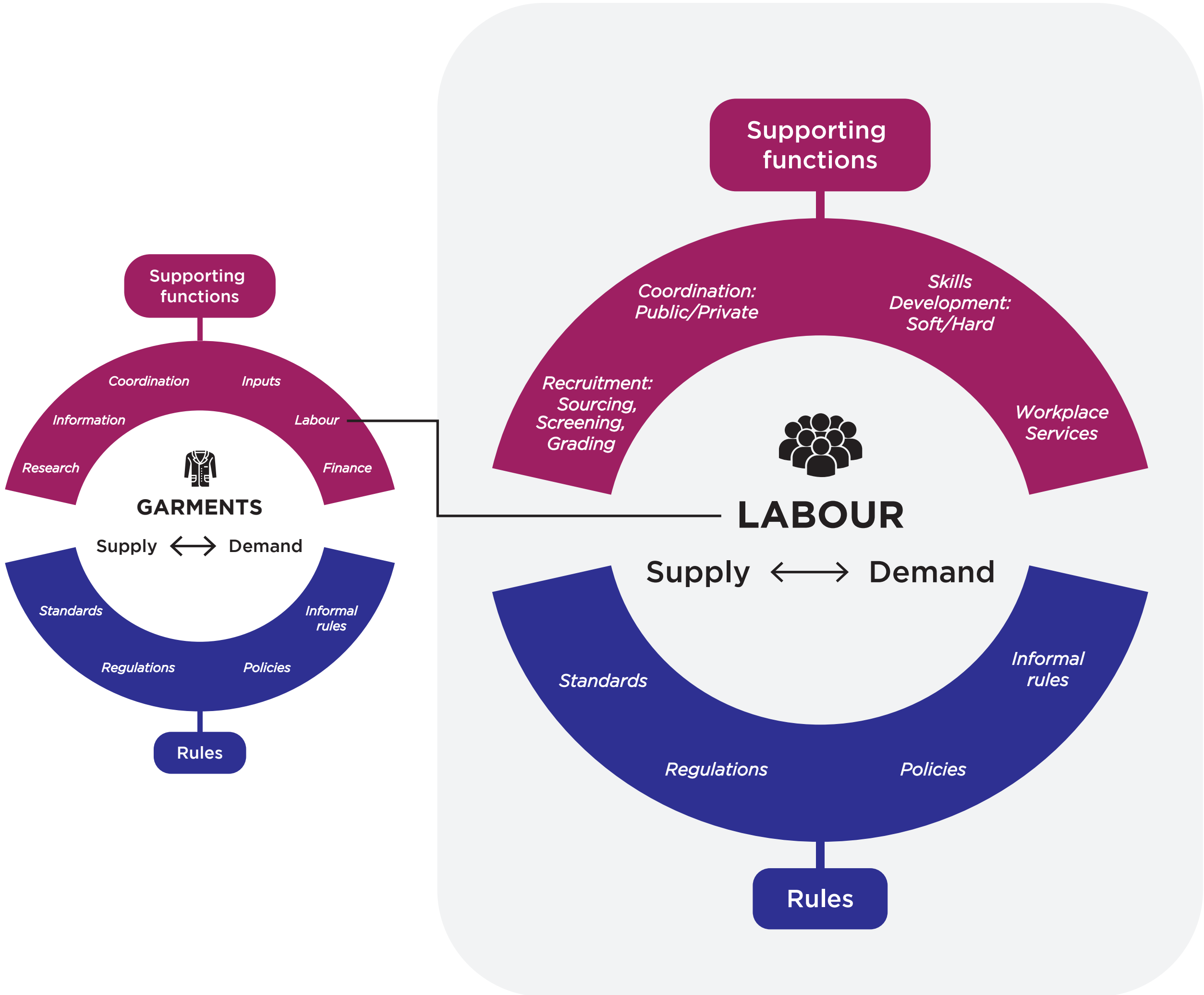
These are a combination of rules (e.g. formal laws and informal cultural norms), regulations, standards (e.g. private and public) that influence market player behaviours to enter (or exit) the core of the system.

The Labour Market System in Garments

The market system for garment manufacturing enjoyed favourable rules (e.g. trade agreements and tax holidays) and supporting functions (e.g. infrastructure, duty free import of raw materials and equipment and external financial flows) with the exception of a weak labour response to garment sector jobs for reasons related to perceived low wages, high transaction costs (re-locating to communities near the factories) and unfamiliarity with an industry work culture.

Opportunities for inclusive growth in the garment sector (primarily jobs for unskilled and semi-skilled workers) were largely constrained by problems in the interconnected labour market system as illustrated in Figure 9. There was no market system to effectively perform the inter-related functions of sourcing, screening, job matching, developing skills and retaining workers for industry jobs.

Figure 9 Missing/weak inter-connected market system



Part 2 Results revealed that EP and its partners succeeded in creating a labour services market with the capacity to meet current and future factory needs for entry level workers. EP facilitated this journey of discovery by engaging all stakeholders in an iterative process of testing, through demonstration, the best alignment between system functions and the players best positioned (e.g. incentives and capacity) to effectively perform these functions. There were many 'ah-ha' moments and pivots along this journey, as described below:[28]

- EP and other stakeholders focused, initially, on soft (work habits) and hard (technical competencies) skills training of new recruits assuming there would be a strong supply response to the many thousands of job openings. EP supported private trainers to deliver soft skills whereas a government institute delivered hard skills training. The unexpected slow/low labour response to job openings reduced the importance of a skills training intervention compared to more urgent priorities of sourcing and screening prospective employees at scale and then matching them (through testing) to available jobs.

- EP pivoted to a public/private sector model of cooperation to address the absence of these critical labour market services.

[28] Bekkers, H. (2020), *Enterprise Partners in Support of Industrial Transformation: Building and Industrial Labour Services Market in Ethiopia*, Enterprise Partners.

Regional governments stepped in to take on the sourcing/screening function as they could leverage their trust with local communities (factories had not yet earned community trust) and educate prospective employees and their families on the benefits of jobs in garment factories. With an organised sourcing/screening function in place, supply gaps began to narrow but labour shortages remained and more issues followed.

- Factories started to bid on wages and/or poach better workers through financial inducements to meet their own individual factory needs. EP convened stakeholder forums to respond to this and other emerging issues. Through coordinated dialogue, garment factories agreed to recruit workers – entry level and beyond – through the government recruitment channel while also agreeing on a private walk-in recruitment channel to fill urgent and specialised recruitment.

- When it became evident the garment sector needed a more sophisticated way to forecast labour demand and supply across all job categories, EP temporarily filled this capacity gap by engaging the services of a local IT company to build and operate a more sophisticated database. The ownership of this database would be transferred to a government entity.

- EP would make two more pivots in the course of its interventions: (i) once garment factories concluded that they were best positioned to train workers in both soft and hard skills in-house, EP assisted factories to put in place a cost-effective training programme, using more learner-friendly audio-visual methods; (ii) labour productivity and worker retention, while improving, would only make further improvements by means of better factory-based human resources policies/systems tailored to the needs of an Ethiopian workforce. EP facilitated the creation of a vesting retirement savings programme to improve worker retention by facilitating links between factories and MFIs. This financial service had a positive effect on worker retention. EP's efforts to encourage foreign factories to adopt better human resources policies remained a work in progress at the conclusion of EP's engagement.

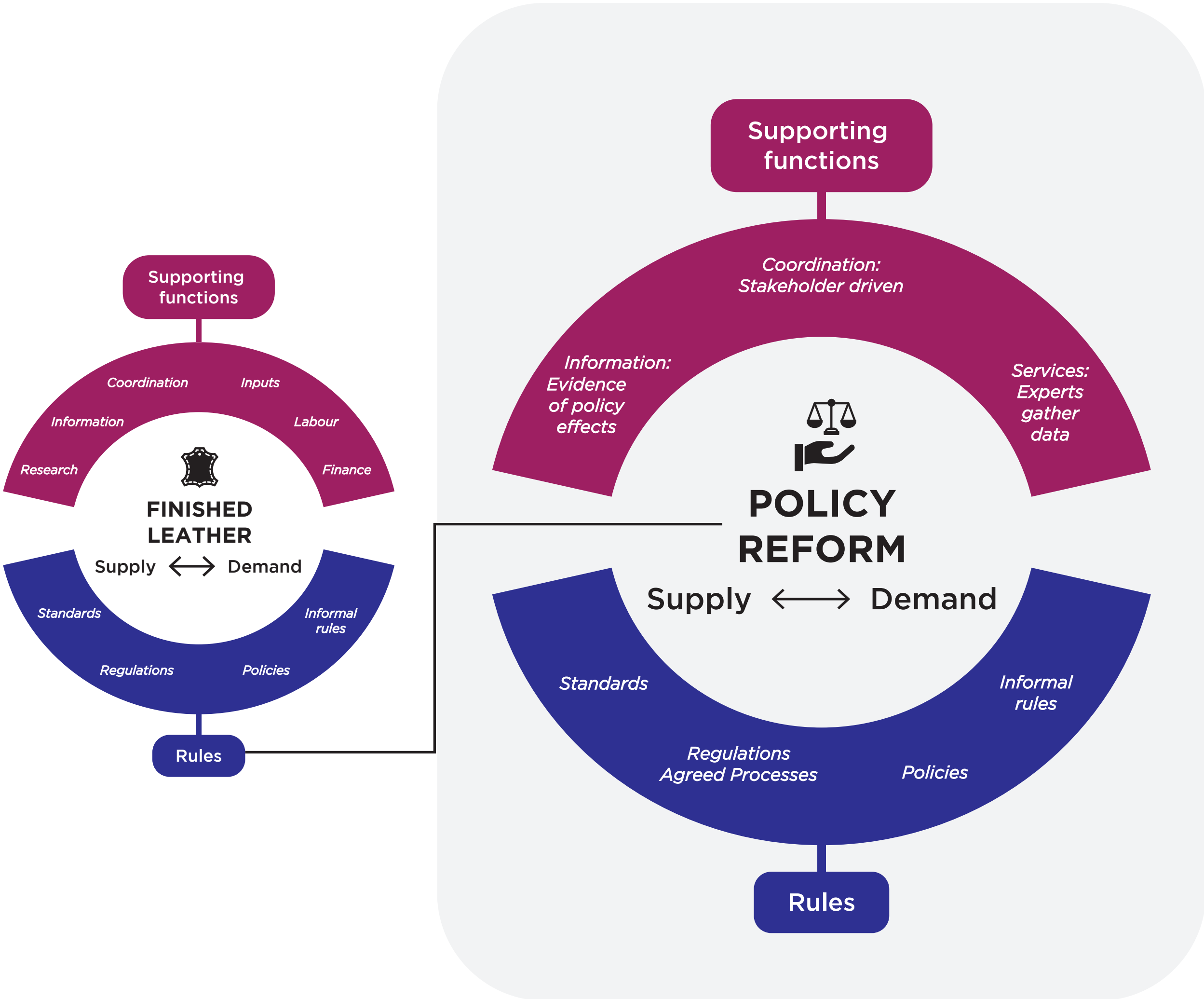
Finished Leather Market System

In 2019, the GoE concluded that its imposition of a 150 percent export tax on semi-finished leather was not working and, in fact, had negative effects on the leather sub-sector with the closure of domestic tanneries, declining export sales and lost jobs not compensated by new FDI investments and increased sales of exported leather products. The GoE dropped the export tax, allowed the resumption of exports of semi-finished leather and put in place a stakeholder-driven leather sector roadmap to encourage a more gradual transformation of Ethiopia's leather sub-sector. Part 2 of this paper briefly describes how EP influenced this policy re-formulation process.

In 2014, however, when EP began its engagement in the leather sub-sector, the GoE had recently adopted the export tax and backed its implementation through the MOI and its leather sector institute. There were already rumblings from leather tanneries about what they perceived to be a 'sink or swim' dilemma: either make radical shifts in their business model or go out of business.[29] This presented a very difficult context for EP to facilitate transformation in the tanned leather market system as is illustrated in Figure 10.

[29] Yilma, T. Tessema, W. and Grant, W. (2020), *Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions*, Enterprise Partners

Figure 10 Disabling formal rules distorts incentives in the core



Like labour in garments, there were many twists and turns in this journey which eventually led to EP's facilitation of a change in policy with the evidence generated from supporting some of the local leather tanneries navigate a disabling policy environment. These twists and turns included the following:[30]

- Chemical companies had knowledge of buyer specifications for finished leather at a time when local tanneries wishing to make a shift to higher value markets did not. EP tested the feasibility of chemical companies adopting a 'sales plus service' business model in support of a few tanneries who were ready to shift into higher value finished leather export markets. Five tanneries secured commercial orders and increased their sales, but the added cost to chemical companies of embedding technical assistance in their sales strategy was not sufficiently compensated by increased chemical sales, leading them to cease their support.

- Tanneries required more intensive, diversified and tailored assistance than could be provided by chemical companies. EP

[30] DevLearn (2020), *Journeys to Impact: Charting New Pathways from Pilot to Scale for Market Systems Transformation in Ethiopia*, Enterprise Partners

pivoted its intervention to work with market intermediaries to link tanneries directly with buyers of finished leather. They provided a range of services including technical advice, in-house production support when needed, quality assurance and control, business development, communications and negotiation with buyers. Four tanneries secured 19 commercial orders with eight buyers and were able to bring in an additional GBP 1.2 million. The market intermediary model worked because the incentives between all players – tanneries, their buyers and intermediaries – were aligned around performance unlike the initial pilot where the chemical companies only focused on the volumes of chemicals sold and used.

- EP replicated the market intermediary model with two more tanneries thinking that a more robust proof of concept would encourage other, weaker tanneries to shift to higher value finished leather production. The scale-up step did not succeed in crowding in more tanneries as they concluded that the risk/return ratio of investing in more capacity, know-how and market services was not worthwhile.

- EP concluded that an accelerated shift urged by tax policy to higher value finished leather stretched and stressed the domestic tannery capacity too much to succeed. EP pivoted once again to address the policy environment guided by the results and lessons. The pathway to policy reform is unpacked in EP's case study on influencing government policy.[31]

Horticulture Seedlings

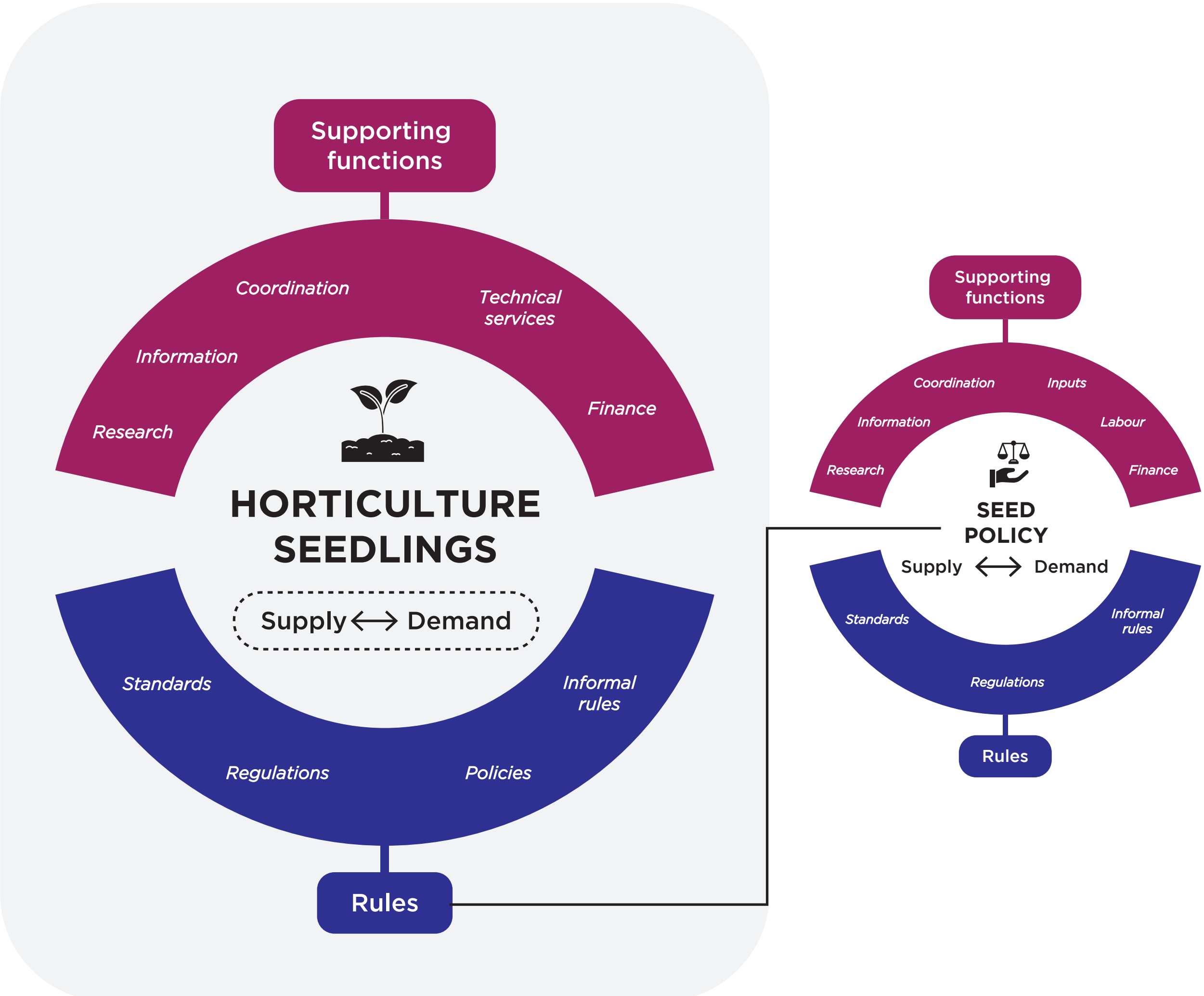
EP's interventions in the commercial seedling market proved to be the only market system where it gained any traction in Ethiopia's fruit and vegetable sub-sector as was discussed in Part 2 Results. EP's work in horticulture seedlings is an illustration of a classic MSD approach, where the starting context enabled the development of a scalable business model first by demonstrating 'proof of concept' and then by replicating it under different market settings to create the conditions for market players to crowd-in. The product already existed, as did relationships between smallholder farmers and commercial farmers, albeit informally.

When EP began its engagement in 2016, it could focus on the core of the market believing that the GOE would liberalise the country's restrictive seed market and open it up to more private sector involvement[32] as is illustrated in Figure 11.

[31] Yilma, T. Tessema, W. and Grant, W. (2020), *Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions*, Enterprise Partners

[32] Ethiopia's Agriculture Transformation Agency (http://www.ata.gov.et)

Figure 11 Finding a scalable business model in the core



At its conclusion in 2020, EP documented ample evidence of smallholder farmer demand for improved planting material which could be supplied affordably by commercial seedling suppliers. EP discovered – through trial and error – a scalable model for the distribution and sale of a perishable seedling product through local propagators serving growers in neighbouring farm communities. Key elements of this journey included the following:

- Initially, EP worked with two propagators – a commercial farm and a seedling company – to formalise current informal sales to neighbouring farmers in order to reach a new, wider market using a sales plus service model (e.g. TA to consumers would be needed to stimulate more sales). The pilot demonstrated the feasibility of a seedling market for smallholder farmers but with a limited range of products (e.g. onion and tomato seedlings) and within a small geographic area.

- EP continued to work with the same two propagators to test the feasibility of a seedling nursery retail business model with increased scope (product mix) and scale (more farmers in more distant locations) while assuring quality delivery of a perishable product. By 2018, the propagators increased their seedlings production by 130 percent and expanded to six new regions, selling quality seedlings to 8,793 new smallholder farmers, compared to 839 farmers during the pilot phase, a 10-fold increase. Propagator costs also significantly increased with expensive investments in satellite nurseries, commissions paid to more marketing agents and the diseconomies of managing retail operations far from the company's base of operations.

- Further expansion of the retail seedling market could not be achieved through a strategy of geographic expansion and by a limited number of specialised seedling businesses. EP decided to facilitate the creation of mid-level local seedling propagators across the country using lessons from the prior two interventions. EP partnered with 14 local propagators who successfully sold seedlings and provided extension services to almost 28,000 smallholder farmers in their respective communities. They continue today without EP's support.

- A scalable model for the production, distribution and sale of a perishable product exists to serve proven smallholder farmer demand for improved planting material. Yet, there remained a yawning gap between coverage and demand. National scale -up was constrained for a couple of reasons. There was limited access to a diverse mix of better foundation seeds for propagators to multiply; the anticipated liberalisation of the seed market had not yet taken affect. No scale agent(s) came forward to fill EP's facilitative role in market system development; the institutional arrangements within government and between government and the private sector had not yet coalesced around cooperation despite EP's urging.

From Inside the Organisation Looking Out

EP's cumulative experience confirms what many MSD practitioners have recognised for some time: an agile adaptive organisation is a critical success factor in MSD programmes. The implementing organisation needs to simulate the very same processes internally to create the enabling conditions for it to read and react quickly and effectively to market system dynamics as they unfold. EP's case study on adaptive management[33] unpacks three specific management crossroads using McKinsey's 7S model,[34] at different stages of project implementation where organisation change was necessary for EP to become more effective. These three crossroads are summarised below.

Stakeholder mis-perceptions

When not paying for change (e.g. direct delivery) but rather influencing others to take ownership of a change process (e.g. facilitation), MSD programmes face the common challenge of correcting stakeholder perceptions around donor funding in order to form real and meaningful partnership relationships. EP needed its stakeholders to see it as a 'partner in business' and 'business-like' where success was rewarded by continuous discovery of better local solutions. EP re-branded itself around this style and then made changes to its staffing, appearance and communications to convey this style to its partners. These 'inside' changes gave EP fresh attention and reception among its 'outside' partners. Its local-but-modern look and feel encouraged confidence that EP's technical capacity was world-class, which was complementary to its attempt to be a capacity builder and a trusted consulting partner.

Demonstrate the value of facilitation

Though strong on the science of facilitation – market research, intervention strategies, monitoring plans – EP was initially less strong on the art of facilitation – the intuitive skills to encourage, advocate, handhold its partners when the outcomes of their innovations (e.g. business models or policies) were uncertain. EP had to strengthen the art of its facilitation skill by rethinking staff competencies (e.g. generalists versus subject matter specialists), staff composition (e.g. nationality, younger professionals and gender balance) and by putting in place a more appropriate human resource system (e.g. highly selective recruitment, compensation package, capacity building). EP discovered that it would need to adapt its core facilitation skill, at times, by taking on a direct delivery role to compensate for the absence of supporting functions in some market systems (e.g. no capacity building skills for MFIs). It did so without undermining its core value (i.e. sustained pro-poor benefits) by ensuring it had an exit strategy when it took on a direct capacity building role for MFIs.[35] These 'inside' organisational changes strengthened EP's ability to act as an effective catalyst or influencer of local stakeholders to take ownership of a change process in support of competitive and inclusive growth.

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[33] Yohannes, L. (2020), *Adaptive Management from the Inside Looking Out: Managing the Enterprise Partners Market Systems Development Programme in Ethiopia*, Enterprise Partners

[34] An organisation is most effective when its 7Ss – structure, system, strategy, skill, staff and style – are all aligned to the organisation's shared values and vice versa

[35] Itana, K. and Grant, W. (2020), *Transforming Financial Service Markets for Micro, Small and Medium Enterprises (MSMEs) in Ethiopia through Direct Technical Assistance to Financial Institutions: The Case of Enterprise Partners*, Enterprise Partners

Seeking synergies between complex sectors

EP's decentralised organisation structure worked to improve its performance by shifting authority and responsibility to operational units, but it also had the unfortunate side effect of discouraging information sharing across teams. Operating units became 'silos' and detached from the big picture which in turn undermined top management's ability to steer the programme and find synergies between sub-sectors with an up-to-date and strategic birds-eye-view of all interventions. EP addressed this structure problem by putting in place an information sharing/planning system, known within EP as the Quality Sector Review (QSR) system. It brought together in one room management, monitoring and results measurement personnel, intervention managers, thematic advisors (gender and green growth advisor), operations and report writers every three months so that they could interact and provide input into each other's decision-making. As a result, intervention teams were able to make more evidence-based, strategic decisions that benefited from monitoring data while report writers' presence waived intervention managers' need to write time-consuming reports and allowed them to focus on implementation. The QSR system contributed to EP's operational efficiency (e.g. value for money) while also finding synergies between sector engagements.

Part 4:
Insights and Lessons

EP's experience is rich in insights useful for stakeholders in Ethiopia's growth policies/plans as they strive for a more competitive, inclusive and resilient economy. MSD practitioners, especially those working in thin/weak market settings, can also draw useful lessons from this experience.

Insight
Disconnect between GoE vision and business reality

The GoE's vision to capture more value-add from its resource endowments of land, labour, livestock, water and agro-climatic conditions, while laudable in its ambition, was disconnected from an understanding of the business reality in highly competitive export markets. Through its GTP I and II, the GoE attempted to force-fit a policy of national industry integration in priority agro-industry sectors without sufficient clarity on the price, quantity and quality benchmarks that needed to be reached to compete against imports or substitutes in export markets. Cotton is one of a number of examples that illustrates this disconnect. The product/market mix for an upgraded Ethiopian cotton sector was better positioned in low volume/high margin export markets (e.g. sustainable cotton) than serving Ethiopia's high volume/low margin garment sector market. The GoE could not turn its resource endowments in raw hides and skins into a competitive finished leather sector simply by policy dictate; a much deeper understanding of the challenges of competing in the global value chain would have changed the strategic approach.

Lesson
MSD Programme Role in Continuously Understanding Market System Change

EP played an instrumental role in shifting GoE thinking around partnering with the private sector to achieve development objectives by taking on a number of critical roles. Its analyses of market system dynamics and change and the sharing of this information offered policymakers insight into the determinants of competitiveness in agro-industry export markets. The experience it gained in translating policies/plans into private sector initiatives with both positive and negative results gave EP the credibility to present evidence of market system change as it was influenced by numerous exogenous and internal factors. Understanding of market system change over time is vital to inform industry stakeholders on policies and plans, especially in thin markets. MSD programmes must position themselves as a credible source of market system intelligence – as did EP – and put in place analysis, planning and monitoring systems designed to inform and influence industry stakeholders.

Insight

Mis-alignment between policies and the institutions selected to implement them

Even when a policy is sound in theory – such as Ethiopia's imperative to increase foreign exchange earnings through agro-industry exports – the institutions selected to implement the policy must understand business realities in order to translate the policy into practice. When the GoE selected the MOI to lead the national integration of the cotton, textile and garment sectors, it biased implementation in favour of industry over agriculture to the detriment of a more competitive cotton sub-sector and the forex it could earn for the country. This was also true for the national integration of livestock, tanned leather and manufactured leather products to the detriment of the raw hides/skins and the tanned leather sub-sectors and forex earnings. The use of FDI as the quickest route to earning foreign exchange was at odds with developing local (Ethiopian) industries that could become regionally and/or internationally competitive.

Lesson

MSD programme role as policy influencer

Taking on the role of policy influencer is a challenge for all private sector development programmes. MSD programmes are uniquely positioned to play a role in influencing policy formulation because they understand the differential effects of policy on all market system stakeholders, either directly through partnerships or indirectly through links to industry associations. EP was able to close the circle between policy and practice and back again to policy as it did in cotton and leather because it understood the market system dynamics/trends, challenges faced by industry stakeholders and the political economy surrounding government policy. EP was able to effectively influence policy because it gained the credibility and trust so critical to facilitate an evidence-based, participatory policy-setting process where consensus-seeking becomes the norm. All MSD programmes could follow EP's example by leveraging their unique position to influence policy from the ground up. They must do their own due diligence of understanding of the political economy,[36] driving policies and plans and the institutional arrangements around which policies get implemented. The role of policy influencer is critically important for an MSD programme, especially in thin/nascent markets and in state-led development paradigms to counteract the out-sized influence of a few well-connected players to bend policy towards their narrow business interests, or to take advantage of an opportunity to facilitate a stakeholder-driven evidence-based policy (re)-formulation process because all stakeholders are still finding ways to succeed.

[36] Political Economy Analysis tools in use by MSD programmes: https://beamexchange.org/guidance/analysis/political-economy-analysis/; https://www.marketlinks.org/post/how-thinking-and-working-politically-through-applied-political-economy-analysis-critical-market

Insight

Disconnect between FDI and increasing competitiveness of domestic firms

Ethiopia's limited economy could not drive desired growth. Domestic firms could not compete in global export markets. As such, the GoE chose to drive growth by attracting FDI in priority export sectors. It was hoped that foreign firms would raise the bar of competitiveness and transfer technology and know-how to local firms in exchange for GoE incentives and subsidies. EP positioned itself with domestic firms to help them upgrade while also encouraging links between them and FDIs. The record shows that transfer of technology and know-how did not happen primarily because the GoE did not encourage it either through its policies or through its actions. This disconnect sheds light on the fact that all FDI is not necessarily good for a country's growth. Attracting 'smart' FDI requires both local content rules and corresponding investments in human capital to assess the fit between the investor's real interests and the government's growth vision. EP's capacity building support to EIC staff to promote, assess and attract 'smart' FDI was the start of what would be an on-going process.

Lesson

The differences between foreign firms and domestic firms are stark

Foreign firms attracted by incentives to relocate operations in-country and the host country's domestic firms can operate in two different universes in terms of firm size and sophistication. Local content rules imposed on foreign firms by host governments may succeed in bridging the disconnect provided the government has the capacity to enforce these rules. In the case of Ethiopia, the GoE did not have the cross-government capacity – policy setting, technical understanding, customs enforcement – to either set or enforce local content rules.[37] Beyond policy, a more feasible and practical option is for MSD programmes and their government partners to have a separate strategy to upgrade domestic firms to better serve regional or domestic markets. Identify market segments and help domestic firms leverage their locational advantages to compete in these markets. EP identified a promising niche for Ethiopia's cotton sector in identity/green cotton export markets. Implementing a separate strategy for domestic firms first requires convincing government that it is worthwhile to do so. MSD programmes can draw on established literature showing that success in export markets first depends on satisfying domestic markets across the price and quality continuum. Once convinced of the argument, MSD programmes then need to work with government to organise all of its instruments – trade fair promotion, tariff/tax incentives, technology transfer/training, platforms for public/private dialogue – and support domestic firms in this first transformation to greater sophistication to meet more stringent standards.

[37] FDI leather firms were exporting 'semi-finished' leather and labeling it as 'finished leather', undermining the GoE's own policy.

Insight

Unlocking investments in infrastructure (industrial parks) or in lending capital (under-used credit lines) requires corresponding investments in human capital

Ethiopia made major investments in state-of-the-art industrial parks to stimulate export growth. Buyers for international brands came. Foreign-owned garment factories came. Ethiopian labour did not come initially and, when it did, not at the required scale until after a labour services market system was put in place. Available capital for lending (e.g. credit lines from the World Bank, EIB and others) were rapidly utilised when investments were made in building human capital across the financial services market system (e.g. DBE and MFIs) to effectively lend to the large under-served market segment of small productive enterprises with knowledge of new MSME lending policies. EP's interventions in building human capital showed the GoE how to optimise and plan for public sector investments in stimulating growth.

Lesson

MSD programmes may need to directly deliver services to stimulate wider market system change

Ethiopian markets are thin and many of its export-led industries are in the nascent stage of their lifecycle. The volume and value of transactions are insufficient to foster the development of a specialised service economy in support of these transactions. MSD programmes may need to directly deliver services to the core market actors to speed up the development of a market system, while also building the capacity of the consultants, trainers, ICT companies or other key players to enable them to perform these specialised functions in the future. The critical caveat for all MSD programmes is: if what an MSD programme does directly today and what it does is critical to the future functioning of the market system, then who is going to do it when the MSD programme is no longer there? Two important lessons for MSD practitioners emerge from this axiom. The first lesson for facilitators is that in thin markets they are likely to intervene with a heavier touch (e.g. direct delivery of training and services) and then, as the market for capacity building improves, shift to lighter touch facilitated interventions (e.g. information on opportunities for trainers or consultants). The second lesson for facilitators is familiar and bears repeating: when entering a market system to perform a critical function make sure an exit strategy is in place – who is going to do what you are doing, why, and how will they get paid?

Insight

Leveraging accomplishments within and between sectors

Industrial parks in Mekelle and Kombolcha faced the same issues in attracting labour for garment factory jobs as did Hawassa but with one critical difference - all stakeholders (factories, local government, prospective recruits and their families) had the benefit of a proven system developed at Hawassa Industrial Park to recruit and retain workers. EP and its partners were able to leverage their accomplishment and replicate it to other industrial parks, which would make adjustments to fit their needs. When it became evident that GoE policies were failing to shift private sector behaviours to capture more value-add in leather and cotton, EP was instrumental in facilitating an evidence-based, stakeholder-driven process of policy reform. The lessons from the cashflow-based lending pilot in WEDP convinced the GoE and other donors to increase investments into lending to SMEs. This opened up a large and under-served market for lending and leasing for MSMEs across a range of productive sectors in the economy. Garment factories created a vesting retirement savings programme to improve worker retention in partnership with MFIs. EP staff facilitated this link faster than it might have happened on its own because they saw the opportunity as a result of working on issues in different but inter-connected market systems.

Lesson

MSD as a strategy for sustainable impact at scale

Most MSD programmes need between two and three years to understand the real underlying causes of market system dysfunction in order to set priority sub-sectors on a pathway to more competitive, sustained and inclusive growth. They often come to realise during this experimental stage of their work that similar problems recur across the different markets systems. When they discover mis-alignments between market system functions and the players' capacity to perform these functions, they focus on a better understanding of player incentives and capacities (e.g. a common issue in weak/thin markets). The solution to under-performance in one market system is often found in solving a problem in an inter-connected market system. When they discover a clash in incentives between market players, often distorted by policy or culture, MSD programme focus on strengthening system functions of information or coordination to enable stakeholders to see the benefits/risks of cooperation (e.g. roadmaps in cotton and leather). This process of discovery and adaptive management defines EP's seven years as an MSD programme in Ethiopia from which one more important lesson can be derived – the holy grail of impact at scale for donor-supported economic development investments is best achieved by better functioning market systems with the capacity to meet the tests of competitive, inclusive growth over time.

Conclusion

EP's journey of facilitating the development of numerous market systems in Ethiopia has been anything but straightforward. EP intervened in complex market systems where cause and effect relationships did not always conform to expectations of how things should work. EP used best practice diagnostic tools to identify inclusive growth opportunities and understand the corresponding market system dysfunctions blocking these opportunities. EP formulated strategies, identified interventions, selected appropriate partners and finally took a view on how change is likely to unfold as a result of programme support. Yet, strategies and plans at the outset of most MSD programmes are, at best, informed 'guesstimates', especially in sectors at the early/nascent stage of development. What EP didn't know – and couldn't possibly know in advance of its engagement – is how different sector stakeholders would respond to incentives (or sanctions) promoted by the programme or other actors. A concluding message EP's experience offers to the wider MSD community of practice is this: *EXPECT THE UNEXPECTED* and adapt accordingly.

This paper is both a reflection and summation of the five case studies that form EP's series of knowledge products as the programme comes to an end. The reader is encouraged to read these cases as they offer insights and lessons on some compelling questions/issues when development programmes invest in the MSD approach to competitive and inclusive growth, including:

When is it appropriate for a facilitative MSD programme to use a direct technical assistance approach?

MSD programme stakeholders – donors, managing contractors and their in-country leadership teams – must embrace and value learning and adaptation. They should allow for the use of a mixture of (evolving) models of facilitation from an externally driven 'heavy hand' when dealing with thin markets, leading to an internally driven 'lighter touch' facilitation as the markets mature. The EP case entitled Journeys to Impact: Charting New Pathways from Pilot to Scale for Market Systems Transformation in Ethiopia shows the reader about EP's experience in learning, adapting and changing its interventions towards the goal of inclusive growth.

Ethiopia's financial sector was not responding to the needs of MSMEs, many owned and operated by women. EP's case on Transforming Financial Service Markets for Micro, Small and Medium Enterprises (MSMEs) in Ethiopia through Direct Technical Assistance to Financial Institutions: The Case of Enterprise Partners reflects on how EP's consultants and staff provided direct technical assistance to financial institutions to create new cashflow based products to expand their markets. EP played a direct role as a capacity builder, which created demand for services, while also building the capacity of the local consulting and training firms to respond to that new demand, which would not have happened without this kick-start.

How should an MSD program think about/plan for sustainability, when it is not likely to happen during the life of the project?

The MSD community of practice defines sustainability as the capacity of a market system to sustain benefits without continued donor support. Best practice MSD programmes begin implementation with a sustainability strategy against a future vision of who (e.g. government, private sector, civil society) should perform what market functions (e.g delivery, rules, support) as driven by their incentives and capacities to effectively perform these functions. Donors and their implementing partners are not considered market actors but enablers or facilitators of this vision of sustainability. EP succeeded in building an effective labour services market which can serve Ethiopia's emerging export garment sector at increasing scale for entry level workers. EP has exited and more donors and their partners have entered the industrial labour market. Does this conform to the definition of sustainability? We think yes. New donor support is expected to enable the GoE to strengthen its relationship with the private sector and improve its role as awareness raiser of job opportunities and regulator of labour markets typically performed by government. The case entitled Enterprise Partners in Support of Industrial Transformation: Building an Industrial Labour Services Market in Ethiopia tells this story.

EP's work on training new banking advisors to MSMEs is another, yet somewhat different, example of what sustainability actually means in an MSD programme. So much of EP's work in financial services was aimed at creating new, highly demanded financial products which in turn created opportunities for fee-for-service advisors to MFIs and their customers. The sustained delivery of technical services in support of the financial institutions could not happen within the project horizon. This EP intervention is not yet sustainable, but it is clearly on a sustainable pathway, although it will require continued donor support for a few more years. The case entitled Transforming Financial Service Markets for Micro, Small and Medium Enterprises (MSMEs) in Ethiopia through Direct Technical Assistance to Financial Institutions: The Case of Enterprise Partners tells this story.

Should an MSD programme play the role of policy influencer?

Many MSD programmes focus just on the private market actors. But the government is a critical actor in all market systems. EP demonstrated how MSD programmes can play the unique role of informing and supporting policy choices from the bottom up with evidence on how incentives/sanctions influenced private sector behaviours in support of government policy. EP's case entitled Changing the Rules with Strategy, Evidence and Action: Lessons from our Cotton and Leather Interventions highlights how EP engaged the GoE to rethink many of its policies using an evidence-based, participatory process. EP's experience encourages all MSD programmes to wear the hat of policy influencer/supporter in order to create effective feedback loops from experience back to policy in order to create the right enabling environment for inclusive economic growth.

Are MSD programs organised and encouraged to be agile learning organisations?

Effective MSD programmes should be able to simulate internally the processes of learning, adapting and changing so that programme staff can be effective at stimulating these same processes within the market systems they seek to improve. How MSD programmes are organised cannot be an afterthought: careful consideration is needed on how strategy, staffing, structure, systems, style and skills are aligned with the core value of sustained benefits to people living in poverty embedded in an MSD programme. EP's case entitled Adaptive Management from the Inside Looking Out: Managing the Enterprise Partners Market Systems Development Programme in Ethiopia tells the story of how EP needed to make continuous adjustments within its organisation to create the conditions for better programme performance.

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