



# WORLD BANK GROUP

## AFRICA REGION, PRIVATE SECTOR UNIT

### Summary of Ethiopia: Developing Competitive Value Chains

*In June 2005 Ethiopia launched its strategy for growth and poverty reduction, the Plan for Accelerated and Sustained Development to End Poverty. Articulated in this strategy, Ethiopia is increasingly focused on developing clusters to catalyze growth. However, despite the reform efforts, Ethiopia is one of the poorest African nations with a GDP per capita of \$130, one fifth the sub-Saharan average.*

*The objective of this study is to consider what, within this larger economic context, can be done to strengthen the competitiveness of Ethiopia's private sector and to create jobs of sufficient levels of productivity and volume to have a tangible impact on poverty. Specifically this study provides a value and supply chain analysis for the roses, road construction, housing construction, leather products, and garment industries, addressing issues of market structure and other industry characteristics to identify potential interventions at both industry and public sector levels that may make these high potential value chains more competitive. The key challenge for Government will be to continue to reduce anti-competitive policies and push forward innovative solutions for private participation in the provision of services.*

#### Overview of Selected Industry

Cotton-to-Garment Industry exports have seen steady growth in the last three years to 2005 and the cotton-to-garment value chain in Ethiopia offers substantial opportunities in both regional and international markets. This can have huge impact on poverty reduction since the sector employs over 517,000 people, with the bulk of employment coming from the informal sector.

However, both production and supply chain inefficiencies, along the cotton-to-textile value chain prevent enterprises in Ethiopia from becoming a global player, especially in the face of fierce competition post-AGOA. The key challenge in this sector is for Government to remove the barriers

#### Horticulture/Floriculture Sector

The diverse agro-ecological conditions in Ethiopia have considerable potential to produce a wide range of tropical and temperate horticulture produce for both domestic and export markets. Besides these, the country has easily trainable low-cost labor force and has a location advantage due to its proximity to the Middle East and Europe.

However, investment in the sector has been hampered until recently by the difficulties associated with securing land for production. With the recent nomination of horticulture as a "strategic industry" some of these constraints are easing. Government incentives, including subsidized air transport, land, access to finance and tax incentives play an important role in the sector but they raise questions of sustainability.

#### Leather and Leather Products

The leather industry is one of the leading industries that generate foreign exchange. It also creates employment opportunities to a large number of rural and urban populations—over 800 registered hides/skins traders, and about 6,000 tannery and leather good factories employees generate income from the sector.

Despite this contribution, the sector is highly constrained by supply, quality, market, skilled manpower, finance, constraints. All participants operate independently, all transactions are arms-length and cash-based. Prices fail to reflect premiums for superior quality inputs. No cross or joint investment exists and participants are having difficulty emerging from their low productivity trap. New technology introduction is minimal, capital equipment is dated,

industry restructuring has not occurred and capacity utilization is low and declining. Additional issues with which the industry must deal in its collective efforts to strengthen the capabilities and competencies which operate within its value chain include the following:

- ✦ Lack of differentiation.
- ✦ Low capacity utilization.
- ✦ Lack of coordination.
- ✦ Weak backward linkages.
- ✦ Weak forward linkages.
- ✦ Loss of market share.

### **Construction**

The Ethiopian building and construction is currently experiencing a cyclical boom. However, most Ethiopian based construction companies compete at a significant disadvantage to foreign construction companies for large public works projects which are financed either through multilateral donors, unilateral donors or, indeed, through government budgets which applicable public works procurement processes are tied to indirect donor financing. Additional efforts to strengthen the capabilities and competencies which operate within its value chain should address the following:

- ✦ **Supply constraints.** Demand currently two to three times larger than available supply. All cement in Ethiopia is provided by one state-owned cement plant and one state-affiliated cements plant.
- ✦ **Bidding constraints.** Local firms are unable to compete for major projects funded by donors.
- ✦ **Project management skills**
- ✦ **Building standards** are not effectively enforced on private projects.
- ✦ **Construction finance.**
- ✦ **Low productivity.**
- ✦ **Low levels of collaboration.**

### **Cross-cutting Themes**

The analysis identifies several constraints to competitiveness and productivity of these chains, which fall into five broad categories. First the issue of state intervention in markets and the unintended consequences created when those markets lose their responsiveness and flexibility to changing circumstances; coordination failures, skill acquisition, capital and finance.

### **Public Intervention in Markets**

Subsidizing raw materials to the public sector for priority projects, effectively reduces the ability of the market to respond to demand signals, but moreover, sends signals to those who cannot obtain the materials at the ex-factory price, firms who tend to have less connection with Government, that there is an access bias. I

### **Coordination Failures**

There is a necessity for coordination across sectors. In the leather industry for example, development of shoes will depend on coordination with animal health authorities. In other industries, supply constraints would be solved in part through market signals. However, unorganized informal supply chains where there exists no traceability leads to inconsistent price referencing. This is the case with the domestic supply chain for hides and skins. The supply chains are unorganized, informal and hence there is no traceability back to farmers, a major problem where skins are often prone to Ekek. Hence the price referenced grading system endorsed by the Tanners Association has failed to be consistently enforced. Market signals will need to be supplemented by public sector efforts by Ministry of Agriculture. Clearly, the livestock sector's development and evolution through investment in commercial feedlots and abattoirs will play an important role in creating a viable supply chain.

### **The need for more specialized inputs**

As each sector develops and specializes, increasingly sophisticated support services will be required that would not be delivered within each firm. Logistics is a key example. The logistics needs of the flower industry are paramount, as logistics consumes three-fourths of the price paid by the Dutch auction and accounts for 74% delivered cost of the flowers. Current arrangements consisting of self-delivery from growers to EthioHortishare, which delivers to Ethiopia Airlines cargo services, are not specialized enough to provide for the needs of this sector if it is to compete globally with growing competition from Kenya, Uganda and South Africa.

### **Financial sector reforms**

The inability of the current financial sector to effectively finance the evolving needs of the private sector is not unique to Ethiopia. The World Bank and Government of Ethiopia have made strides to support the opening of this sector through the agreed Financial Sector Capacity Building Project.

**Table 1. Benchmarking Labor Productivity, Selected Countries**

Number of Garments Produced Per Machine Operator Per Day (8 hours)							
	China	Ghana	India	Kenya	Lesotho	South Africa	Ethiopia
<b>Men's Knit Shirt</b>	19–22	12-14	16	12–15	18–22	15	10–12

Source: For Knit Shirt, compiled by Global Development Solutions from industry sources.

### Skills

The value chain analysis highlights the often wide gap between productivity levels of Ethiopian labor and foreign labor. As table 1.0 highlights the extent of this gap - with an average productivity level of ten shirts/operator/day, it will be difficult for Ethiopia to compete with countries such as South Africa and Kenya. A prerequisite for increasing the competitiveness of sectors such as the garment sector is for the private and public sector to join efforts in establishing technology centers, in the garment industry's case, modeled after proven centers in countries as Mauritius.

## Conclusion and Policy Suggestions

### Public Private Dialogue Forum

The volume of sector problems raised demands not simply a policy matrix or a list of recommendations but rather an ongoing process through which common solutions are discussed, implementation agenda developed and carried out within a structured implementation framework. Building on experience, dialogue would consist of a bi-annual forum for discussion of high-priority issues at the Parliamentary level supported by several working groups grouped by sector which would involve more frequent debate.

### Cluster Development

To achieve targets set out in PASDEP, addressing these priority constraints is not enough. Under strong collaboration, including establishing industry-sponsored research, joint identification of markets and strategic plans can contribute to the development of competitive clusters. The

World Bank Private Sector Capacity building Credit and the recent GTZ Engineering Capacity Building project will work to support the critical sector leadership established by associations and the firms themselves.

### Institutional support

In order to move away from evidence based dialogue to actual implementation of reform, Ethiopia should consider the institutional requirements and how best to strengthen these- possibly through a public private institution that has the mandate, resources and capacity to carry out, monitor and evaluate the implementation of industrial policies.

### Corruption

Formal firms perceive corruption to be more of a concern for growth than any other constraint. Objective data on informal payments to government clarifies this relationship -- the informal firm has to pay more payments to government on average, which can be classed as the price they pay for government services. However, since it is not registered it pays fewer taxes than the formal firm. Therefore it is not surprising that the formal firm begrudges informal payments more, since they are effectively being double charged.

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This note is part of a series of summaries of analytical work of the Africa Private Sector Development Unit. It is based on the report "*Ethiopia: Developing Competitive Value chains*". For more information, visit the website [www.worldbank.org/afr/aft](http://www.worldbank.org/afr/aft)