



Hiring frictions and employment agencies in Ethiopia

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- Firms in developing countries have a hard time hiring college graduates, which exacerbates the misperception of college graduates' productivity.
- This study uses a randomised controlled trial to examine the effect of employment agencies, which significantly reduce the search cost of finding college graduates, on the hiring outcomes of 400 small and medium firms in Addis Ababa, Ethiopia.
- The findings of the study suggest that employment agencies can help firms learn about college graduates' productivity and take more efficient hiring decisions.
- The findings suggest that policymakers can leverage existing labour market intermediaries, such as employment agencies, to address labour market frictions more cost-effectively. Policymakers may also provide more updated labour market information to help firms make better hiring decisions.

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Overview of the research

Firms in developing countries face difficulty finding skilled workers. Often, firms use educational attainment as a heuristic of potential productivity. However, the lack of interaction with college graduates prevents firms from developing accurate beliefs of college graduates' productivity. This poses a particular challenge for many developing countries given the rapid increase in tertiary education in the past decades but mixed findings on its quality (Hendricks and Schoellman, 2018).

We focus on the labour market in Addis Ababa, Ethiopia, which exemplifies high search friction and information friction. We observe a novel type of employment agencies that mainly attract job seekers with a college-level diploma or degree and provide these college applicants to a variety of firms, which significantly reduces the search friction and potentially help firms further learn more about college graduates' productivity. Specifically, we ask:

- What is the effect of employment agencies on interviewing and hiring?
- How do employment agencies affect firms' hiring?
- Do employment agencies help firms learn about college graduates' productivity?
- What is the effect of employment agencies on match quality?

The survey team conducted a baseline survey between May and June, 2022, on 400 small and medium firms that are actively hiring in Addis Ababa, Ethiopia. We adopted a cost-effective sampling method by working with the local government to identify 40 business clusters in two sub-cities and identifying 10 firms in each cluster that are actively hiring. For a random subset of 200 firms, we asked 10 major employment agencies to recommend one qualified job seeker for each position. We then conducted two follow-up surveys in 1 month and 4 months to collect detailed information of applicants and firm-level hiring outcomes. We further increased the sample size by 399 firms between November 2022 and April 2023.

The analysis allows conclusions to be drawn on the roles of employment agencies in alleviating labour market frictions and implications as to how policy markets may use labour market intermediaries such as employment agencies to improve matching between firms and workers.

Policy motivation for research

This research examines the role of employment agencies on improving match outcomes in labour market with a specific focus on college graduates. This is a crucial developmental policy issue which requires extensive analysis for two reasons.

First, young unemployment has become a pressing issue of developing countries, despite the rapid growth in education in the past decades. The quality of college education, however, does not seem to improve, yet firms may not have the most updated information of the reality of college education. This potentially exacerbates the matching inefficiency in the market. Second, more employment agencies see the large gap in the formal labour market and switch focus from previously informal sectors to sectors that may benefit from the skills of college graduates, but we do not have much evidence to understand the roles of these employment agencies on the labour market. It is thus essential and urgent to investigate the function of employment agencies and how to use this newly developed sector for better matching in the labour market.

In the following, we summarise the findings of the study to answer the interested questions from the previous section. We expect that these findings would lead to appropriate policies to improve the match quality in this labour market.

Key research questions	Summary of the key findings
What is the effect of employment agencies on the rate of successful matches?	Despite that only 57% firms in control group hire any worker within 1 month, firms that are matched with an employment agency at the baseline are 9.9 percentage points more likely to hire someone within 1 month.
How do employment agencies affect firms' hiring preferences?	Firms matched with an employment agency are more likely to hire non-college workers, instead of college workers.
Do employment agencies help firms learn about college graduates' productivity?	Firms matched with an employment agency are less likely to think college graduates are more productive. Firms with less hiring experience have a stronger treatment effect, suggesting they learn about college graduates' productivity.
What is the effect of employment agencies on match quality?	Four months after baseline, hired workers from treated firms do not see more turnover, less performance, or less effort, suggesting no negative treatment effect on match quality.

Policy recommendations

Provide labour market information to more firms.

This study finds that firms in Ethiopia suffer from information friction of the labour market, in particular, the productivity of college graduates. Policymakers may provide some aggregate information of the labour market, for example, the unemployment rate of college graduates, to firms especially of smaller or medium size.

Leverage labour market intermediaries to facilitate matching of firms and workers.

The findings suggest that employment agencies not only provide college graduates at a faster pace, but also help firms overcome information friction of the labour market. Many firms expressed their willingness of working with a legal employment agency, but lack of information of the quality because these employment agencies only appear in the last few years. Using the evaluation from this study, the government can potentially recommend some employment agencies with good records of providing jobs to college graduates, so firms are able to search for college graduates or other types of skilled workers.

Improve the skills of college graduates.

The fact that many firms decide not to hire college graduates after the intervention suggests that current college education does not necessarily provide enough skills for college graduates to prepare for the job market. Policymakers may consult with employers what skills they require, incorporate more practical, occupational education into college curriculum. Policymakers may also collect the unemployment statistic of college graduates from each tertiary institution as an index to evaluate the quality of college education.