

# Small and Medium Sized Enterprises in Ethiopia: Capabilities, Job Creation and Growth

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with contributions by

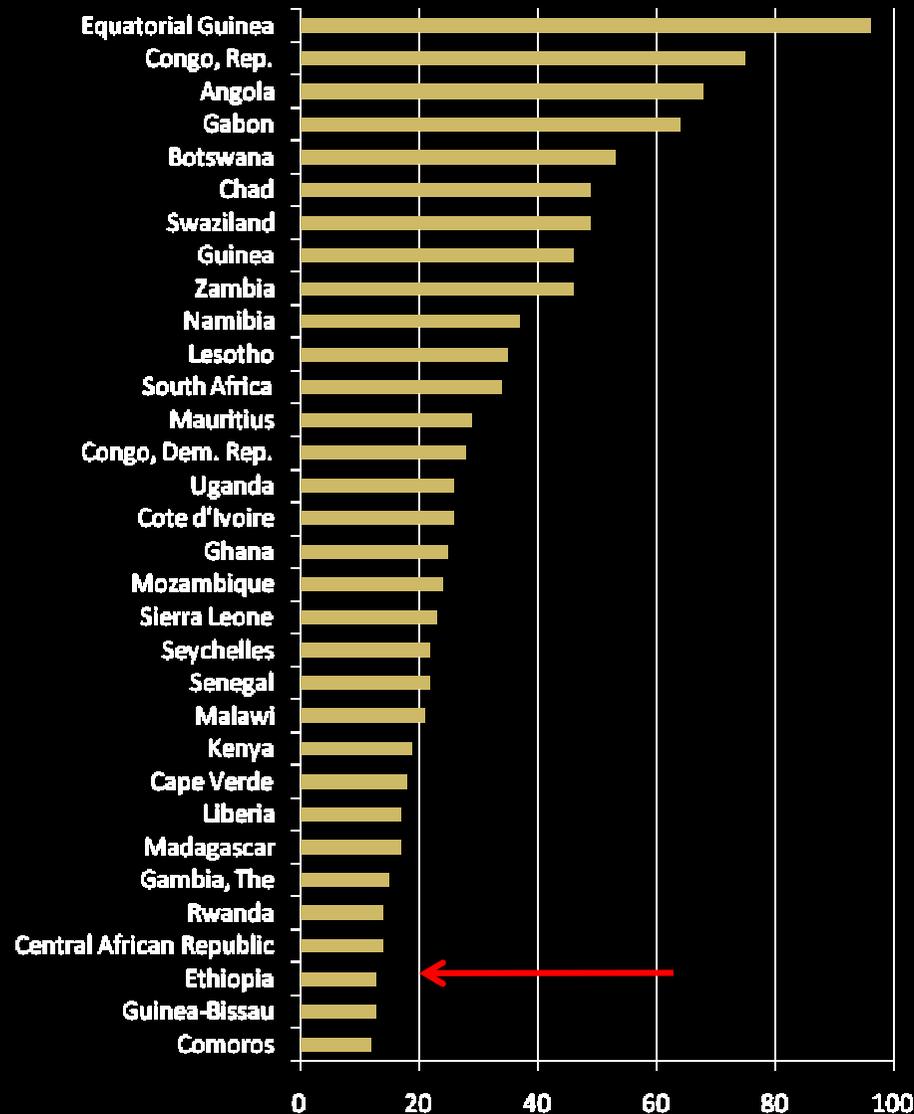
Mulu Gebreeyesus and Eyerusalem Siba

# Context: Industry in Ethiopia

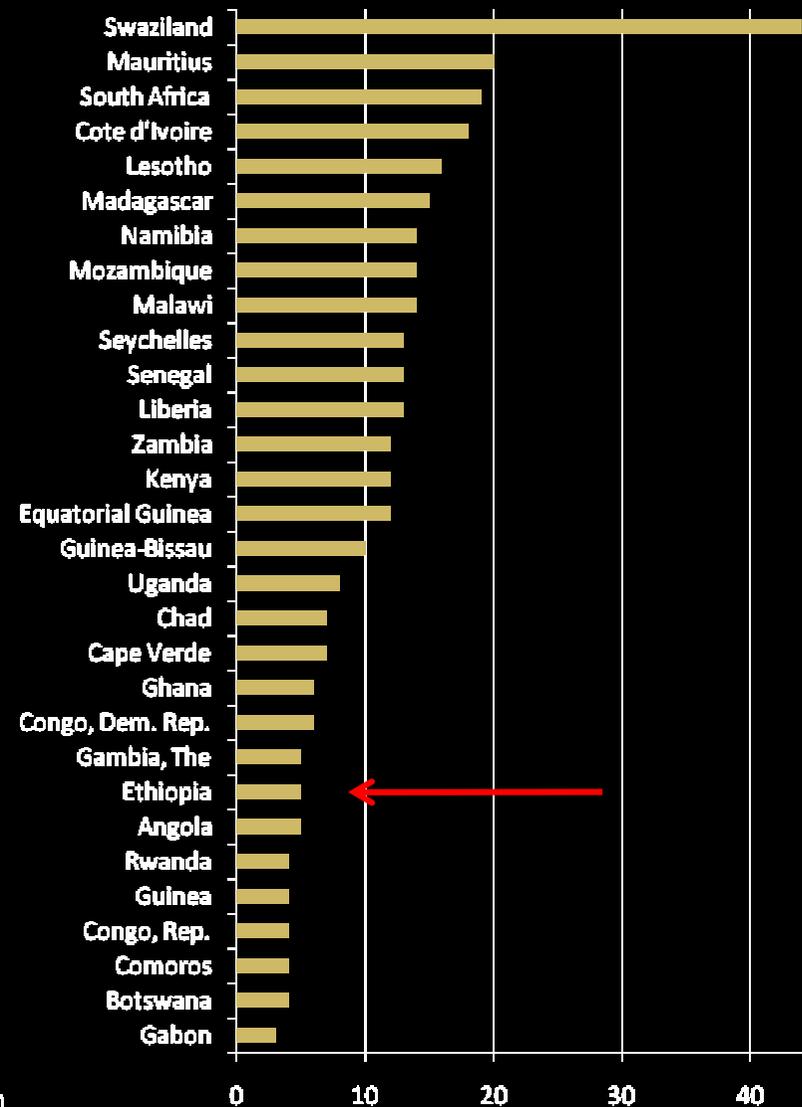
- Agriculture dominates employment (85%) but not output (44%).
- Rapid population growth (3% per yr last decade; 4% urban), limited access to fertile land, and volatile agricultural outcomes.
  - Can agriculture really deliver new jobs and sustained per capita income growth?
  - Industrialization:
    - Diversification. Reduces exposure to shocks; eases pressure on land; higher value-added; etc.
- Ethiopia's industrial and manufacturing sectors very small, even by the standards of Sub-Saharan Africa.

# Industry and Manufacturing in Sub-Saharan Africa

i) Share of Industry in Total Value-Added



ii) Share of Manufacturing in Total Value-Added



## Most of Manufacturing Employment in SME Sector:

- 43,300 small scale firms, total employment **139,000**.
- About 1 million cottage/handicraft enterprises (don't use electricity), **1.3 million** people. (Data for 2002)
- 800,000 urban informal sector non-farm firms (mfg, trade, services), **1 million** persons engaged.
- ❖ Compare to 134,000 workers in formal mfg firms.

## Our research question:

- Can the small and medium scale enterprise (SME) sector be a source of **sustained growth**?

## SME sector a source of **sustained growth**?

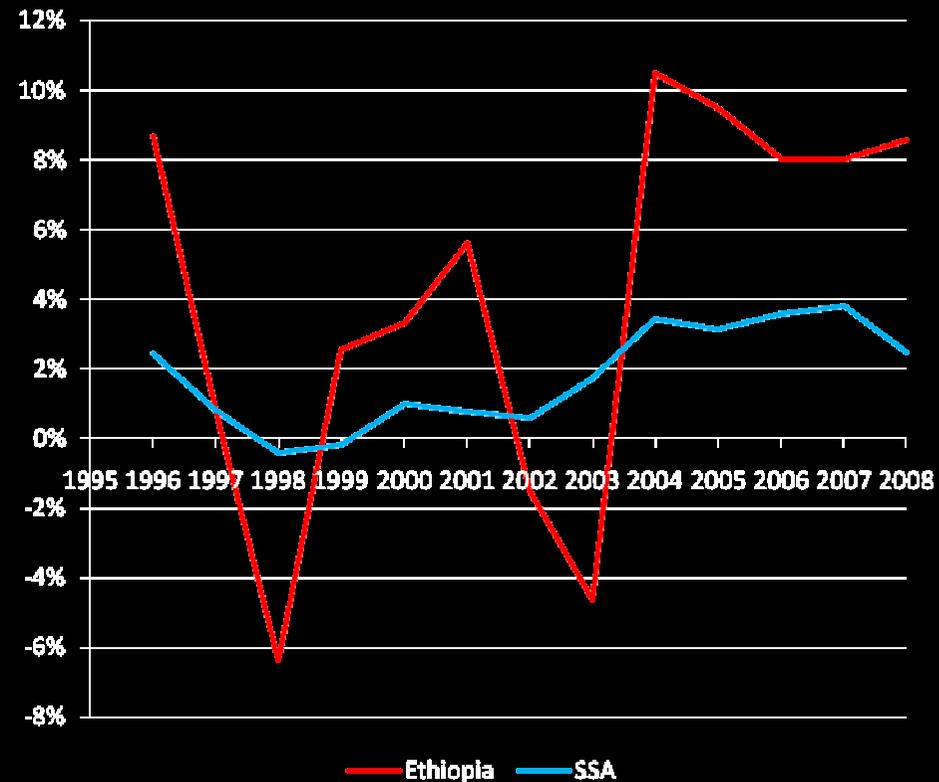
### **Our argument:**

- In principle, yes – but need to produce the right products.
- Ethiopia's SME sector in its current form - unlikely.
  - The type of products produced are basic, lending themselves to mechanized, routine production. Better suited for large-scale production.
  - Data: The value-added generated is low.
  - Data: A small firm is unlikely to grow to become large.
- Of course, the SME still has an important role to play, providing subsistence for unskilled workers.

# The Scene: Industry and Development in Ethiopia

High recent growth...

Growth in real  
per capita GDP



## ...but low exports of merchandise & manufactures:

Year	Merchandise exports per capita (current USD)		Manufactured exports per capita (current USD)	
	Ethiopia	SSA	Ethiopia	SSA
1995	7.4	130.0	0.8	
1996	7.1	142.2		39.8
1997	9.7	139.9	1.0	42.0
1998	9.0	113.9	0.6	33.0
1999	7.3	120.1	0.5	36.0
2000	7.4	139.1	0.7	43.1
2001	6.8	128.0	0.9	38.4
2002	7.0	132.6	1.0	49.1
2003	7.0	158.0	0.8	53.7
2004	9.3	207.5	0.4	
2005	12.1	252.5	0.6	
2006	13.6	290.3	0.7	87.1
2007	16.3	335.1	2.3	110.6
2008	18.6	410.9	1.7	131.5
Average annual growth rates				
95-08	7.3%	9.3%	5.7%	10.5%
00-08	12.2%	14.5%	10.7%	15.0%

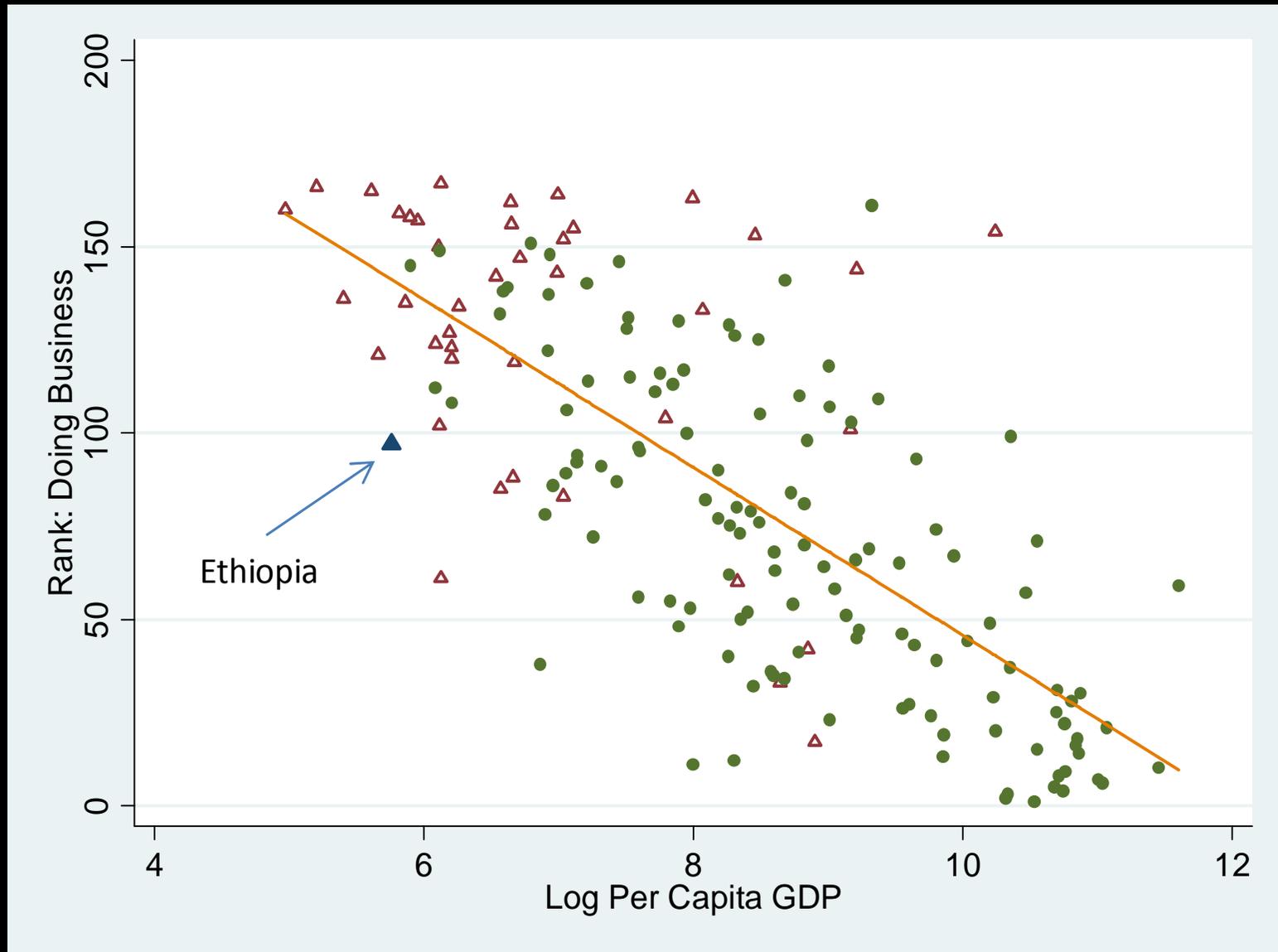
... and no take-off for industry or manufacturing:

	(1) GDP per capita (constant 2000 USD)		(2) Share of mfg in total value-added		(3) Share of industry in total value-added	
	Ethiopia	SSA	Ethiopia	SSA	Ethiopia	SSA
1996	125	504	0.05	0.15	0.11	0.29
1998	118	506	0.05	0.15	0.12	0.28
2000	125	510	0.06	0.15	0.12	0.29
2002	130	517	0.06	0.14	0.14	0.30
2004	137	544	0.05	0.13	0.14	0.30
2006	162	581	0.05	0.13	0.13	0.32
2008	190	618	0.05	0.15	0.13	0.33
Average annual growth rates						
95-08	3.9%	1.8%	0.0%	-0.5%	2.0%	1.0%
00-08	5.4%	2.4%	-2.3%	0.0%	1.0%	1.6%

## Ethiopia's Investment Climate

- Survey data on managers' perceptions indicate that the investment climate in Ethiopia **improved** a lot between 2001 & 2007 (World Bank, 2009).
- Share of firms complaining about the IC is **lower** for Ethiopia than the low-income international averages.
- On 'ease of doing business', Ethiopia ranks quite **high** amongst low-income countries

# Ease of doing business



Note: Countries in SSA = triangles.

**Table 2. Ease of Doing Business in Ethiopia**

	All countries (N=167)	Sub-Saharan Africa (N=42)
Rank: Overall Ease of Doing Business	97	9
Rank: Per capita GDP	162	37
Rank: Per capita GDP (PPP adjusted)	155	31
<i>Rank: Doing Business Topics</i>		
Starting a Business	85	9
<u>Dealing with Construction Permits</u>	56	7
Employing Workers	87	15
Registering Property	99	13
Getting Credit	118	17
Protecting Investors	115	18
<u>Paying Taxes</u>	37	8
Trading Across Borders	146	30
<u>Enforcing Contracts</u>	56	7
Closing a Business	68	9

Source: Data obtained from [www.doingbusiness.org](http://www.doingbusiness.org).

# Manufacturing: Enormous differences in VAD per worker across firms of differing size

**Table 5: Micro, Small and Medium Sized Manufacturing Enterprises 2007/08**

Size range (number of workers)	Less than 10	10-19	20-49	50+
Survey	Small-scale mfg		Formal mfg	
Number of persons engaged	138,951	10,690 [10,616]	14,757 [14,306]	108,226 [63,715]
Number of establishments	43,338	846 [841]	519 [505]	565 [420]
Total value-added	1.14 billion	186.1 million [184.1]	401.1 million [393.4]	8.59 billion [4.58bn]
Total value of capital installed	1.01 billion	244.5 million [244.0]	702.6 million [693.1]	7.58 billion [4.8 billion]
Value-added per person engaged	8,200	17,400 [17,300]	27,200 [27,500]	79,400 [71,900]
Average wage, all paid employees	3,144	3,590	5,750 birr	11,700
Average wage, production workers		2,856	3,640	6,716

Note: All financial figures are in birr, current values.

Source: CSA (2009, 2010)

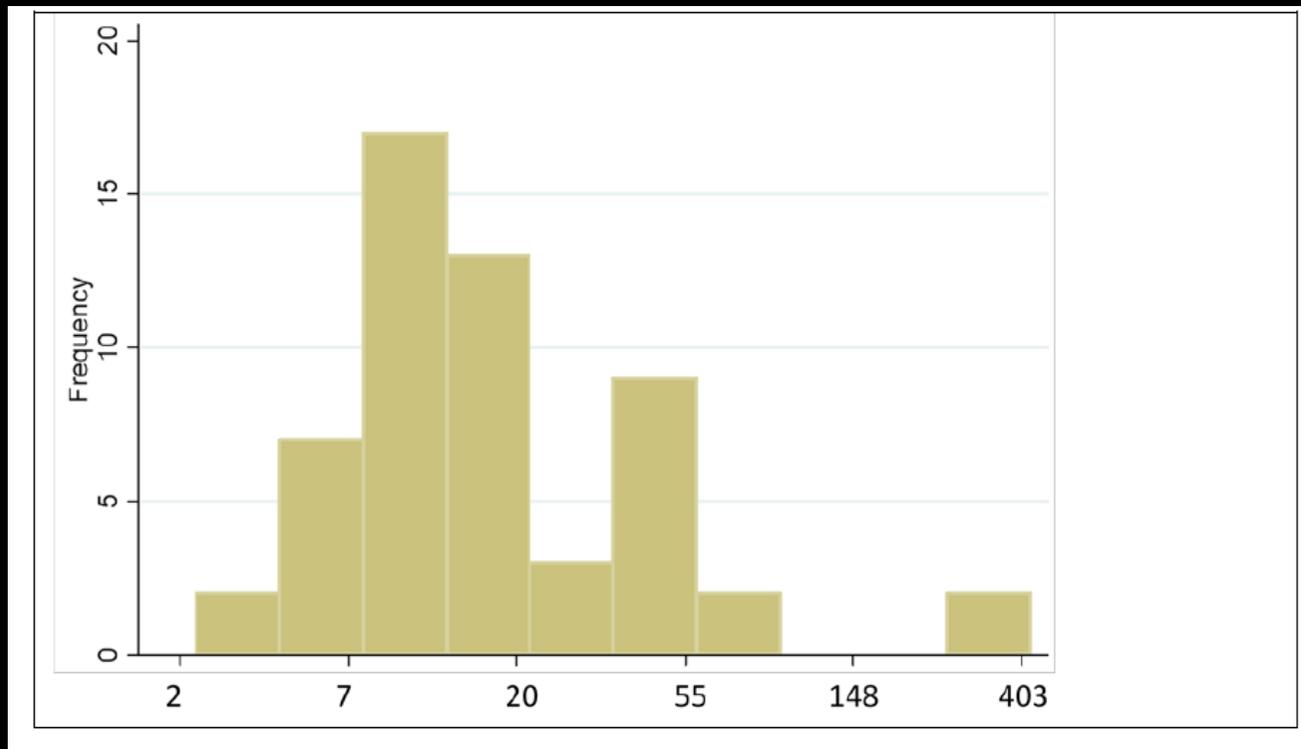
## Size distribution heavily skewed towards low-VAD firms

Size range (number of workers)	Less than 10	10-19	20-49	50+
Survey	Small-scale mfg		Formal mfg	
Value-added per person engaged	8,200	17,400 [17,300]	27,200 [27,500]	79,400 [71,900]

Imagine the gains a **structural shift** might bring about.

## Do small firms grow and become large?

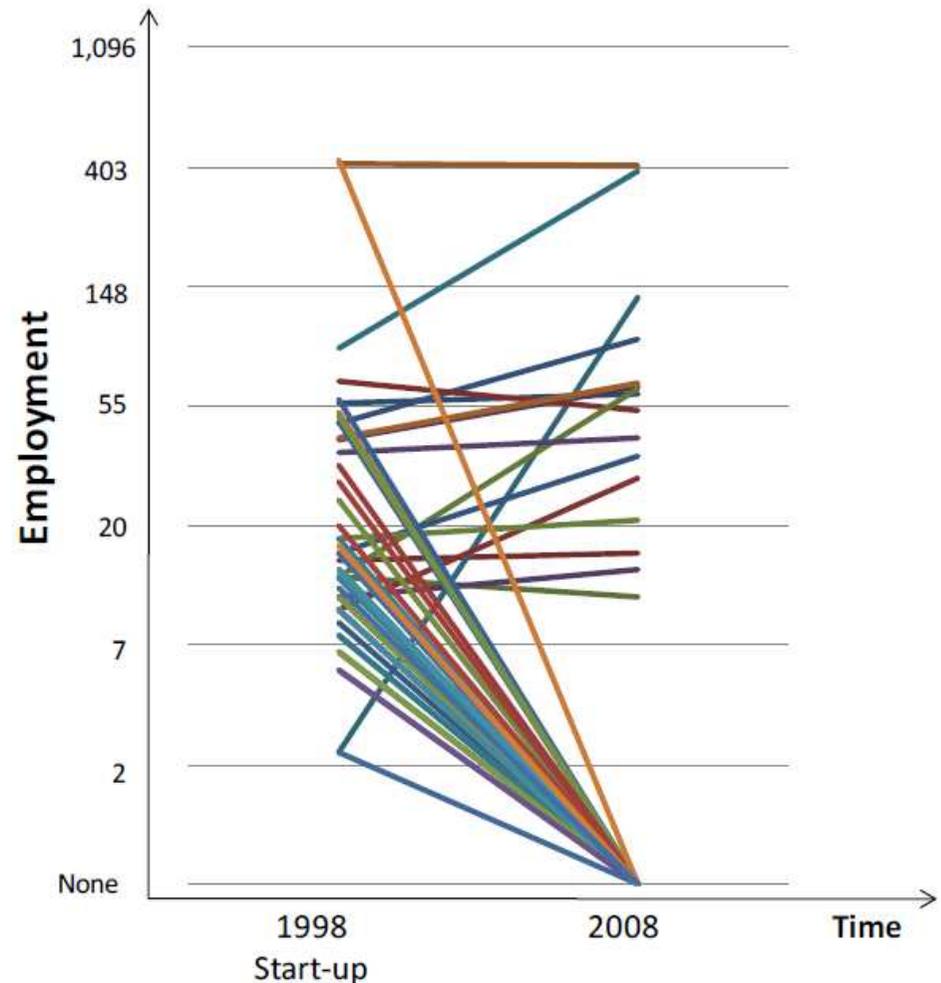
- Analysis of the new entrants in formal manufacturing in 1998.
- There were 55 such new entrants in 1998.
- The size distribution at startup:



# Do small firms grow and become large?

- It happens, but it's very unusual.
- The largest 1998 entrant still the largest firm in 2008.
- Only 29% survive.
- High exit rates among small firms

Dynamics of new entrants:



## Growth conditional on survival is high:

**Table 6. Summary statistics on the evolution of entrants**

	(1) Status of 1998 entrants in 2008
Still in business	29%
Median employment growth if still in business	41%
Still in business & initial size $\leq$ median for entrants	16%
Still in business & initial size $>$ median for entrants	46%
Median employment growth if still in business & initial size $\leq$ median for entrants	200%
Median employment growth if still in business & initial size $>$ median for entrants	17%
Number of entrants	55

## Predicted employment 10 years after startup

- Regression analysis of growth and survival as dependent on initial size.
  - Small firms have higher exit rates; also, conditional on survival, they have high growth rates.
- Net effect on long term employment:



(1) Initial employment	(2) Probability of survival after 10 year	(3) Expected employment after 10 years, conditional on survival	(4) Unconditional expected employment after 10 years	(5) Job ratio
10	0.21	43.8	9.3	0.93
20	0.30	46.0	13.6	0.68
50	0.43	72.0	30.7	0.61
100	0.53	134.9	71.7	0.72
250	0.67	454.4	302.6	1.21

Note: Results are based on the regression results shown in Table 7.

## Tomorrow's large firms won't be found amongst today's small firms

- Large firms start large. Resources:
  - Finance / physical capital
  - **Management skills.**
    - Ability to run large firm.
    - Ability to act in global network – communication, long distance collaboration, etc.
- Today's small scale entrepreneurs typically don't have those skills.

## Summing up

- SME play an important role providing livelihood for poor unskilled people in Ethiopia.
- We are NOT arguing SME are 'undesirable'!
- In principle, small enterprises CAN be a source of rapid technological growth.
- But they need to be in the right line of business, producing the right things. Often high tech, rewarding creative thinking & new ideas.
- High value added crucial! That's what's missing in the SME sector currently.