



## Challenges and Opportunities in Raising Capital in Ethiopia

USAID CATALYZE MS4G is designed to strengthen and mobilize the private sector to transform the food security and water, sanitation, and hygiene (WASH) sectors to deliver improved outcomes for the Ethiopian people. To achieve these goals, MS4G mobilizes capital, increases access to finance, connects enterprises to markets, pilots inclusive business models, empowers young people, and supports stakeholders to self-advocate towards policy change which will promote opportunities for the private sector community as a partner in transformation.

MS4G is a buy-in to CATALYZE, a Washington-based mechanism designed to mobilize private capital for development and disseminate knowledge about blended finance. Implemented by Palladium and funded by USAID/Ethiopia, USAID CATALYZE MS4G works in close coordination with the Mission and the USAID/Private Sector Engagement Hub and collaborates with other USAID implementing partners, Ethiopian enterprises, financial institutions, and advocacy groups.

### BACKGROUND

CATALYZE MS4G operates in an extremely complex and challenging environment in Ethiopia. From droughts and the civil conflict in the northernmost region of Tigray to supply chain disruptions caused by Russia's war in Ukraine that have threatened food security, CATALYZE MS4G has paused, pivoted, and adapted to best meet project objectives and US priorities. In July and August 2022, CATALYZE MS4G organized a series of pause and reflect (P&R) sessions with project stakeholders, including a learning event focused on unlocking private capital to drive inclusive growth. In August 2022, MS4G gathered key stakeholders from the public and private banking sector, such as private commercial banks, insurance companies, fintech companies, private equity firms, transaction advisors service providers, business advisory service providers, partner SMEs (namely BunAroma, Dambi Udoo, Ethiopia Coffee, and others), as well as representatives from the Ethiopian Investment Commission and Industrial Park Corporation, to answer a central question: **What are the challenges and opportunities for raising capital in a constantly shifting business environment?** Participants actively discussed MS4G's operating environment, identified barriers and opportunities to unlock private capital, and shared ideas for improving the overall program strategy and activities. The learning also directly contributed to the CATALYZE Learning Question: **Looking across the USAID CATALYZE portfolio, what configuration of tools/strategies/solutions/implementation approaches has been the most effective in advancing USAID CATALYZE objectives within the specific context?**





## CHALLENGE

A complex and constantly changing operating environment dampens investor confidence and enterprise and job growth.



## OPPORTUNITY

Explore and attract more patient capital sources, such as angel, impact, and diaspora investors, who have a higher tolerance for risk, to introduce more risk-mitigation and catalytic capital into the capital mobilization sector.

## PROCESS METHODOLOGY

This learning brief includes information from multiple sources, including project documents, such as the Performance Work Statement (PWS) and Activity Monitoring, Evaluation and Learning Plan (AMELP) Learning Questions; outcomes from Pause & Reflect sessions with three of the project areas (Enterprise Growth, Youth Programming, and Capital Mobilization); and team reflections on program activities and gender inclusion. Learning gathered from the P&R sessions was summarized into proceeding documents and Action Plans. Where appropriate and where data was available, CATALYZE MS4G evaluated progress made against monitoring, evaluation, and learning (MEL) indicators to provide a data-backed analysis. The team drew on narrative and thematic analyses to develop this learning brief.

## THE APPROACH

CATALYZE MS4G developed clear questions for key stakeholders at a Learning Event, which brought together program participants, implementing partners, and industry players for an open and frank conversation. The Learning Event tailored its discussions to reflect learnings from its Years 1 and 2 activities in capital mobilization, digital transformation, gender and youth inclusion, and resiliency during instability. MS4G used a participatory approach and created a safe and equitable environment to ensure we heard from everyone in the room. We welcomed and encouraged constructive criticism which we know to be the foundation for learning and adaptation. The learning and adaptations that result from the process will be shared with stakeholders through continued dialogue.

## CATALYZE MS4G LEARNING QUESTION



What configuration of tools/strategies/solutions/implementation approaches has been the most effective in advancing USAID CATALYZE objectives in a given context?

## WHAT DID WE LEARN?

### CAPITAL MOBILIZATION

MS4G learning conversations around capital mobilization focused on answering the following question: ***What are the challenges and opportunities for raising capital in a constantly shifting business environment?*** A summary of the learnings is provided below.

***Lesson 1: Generating transformative deal flows that spark growth, create early-stage catalytic business opportunities, and amplify the attractiveness and ease of investing in Ethiopia is a high bar to reach under the current context. We need to adjust expectations around the \$277 million capital mobilization target.***

Ethiopia is a dynamic environment where conflict, COVID-19, and changing political and social influences create uncertainty and amplify threats for the operations of the private sector. Although CATALYZE MS4G was aware of the challenges at the outset of the project, the extent of the challenges, including the national economic impact and their effect on MS4G's program implementation, were more severe than anticipated by both the MS4G team and USAID.

Conflict has spread across a large part of the country affecting at least four of the key economic regions (Afar, Amhara, Oromia, and Tigray), leading to constant insecurity and a high risk that people cannot move freely and safely. As a result, business continuity is uncertain, investor confidence is depressed, and Ethiopia is currently overlooked as an investment destination. A bank president and key stakeholder to the program noted during a panel discussion at the MS4G Learning Event that "Ethiopia has undergone at least nine major shocks over the last two years, and it is amazing that we continue to survive as a nation." Similarly, Ato Aschalew Tadesse, Director at the Ethiopian Investment Commission (EIC) also noted that "everything starts with confidence." Of the \$4 billion mobilized for African start-ups<sup>1</sup>, Ethiopia has received only about \$10 million in the past year. On the equity side, a pipeline of deals has been paused or canceled. It has been extremely difficult to promote Ethiopia as an investment destination. The focus has shifted to retaining and incentivizing businesses to stay in the country.

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■ **Ato Asfaw Melese,  
Dashen Bank**

Sudden policy changes have further dampened private sector confidence. For example, last year, the National Bank instituted a directive which paused all loans to the private sector for six months, having a chilling effect on the private sector and its ability to function. Furthermore, the lack of consultation with the private sector perpetuated the negative perception of the private sector (domestic and international) towards investing in Ethiopia. Other sudden policy challenges included pausing the transfer of deeds for almost a year. This meant that selling and purchasing property was not possible, further slowing down economic operations. Despite these challenges, the team has remained flexible, finding creative ways to raise capital, such as engaging domestic angel investors to promote the growth of SMEs in the food security and WASH sectors. As a learning project, CATALYZE adapts and innovates within the environment in which USAID works. Given the magnitude of the contextual challenges, the private capital mobilization targets should be revisited.

***Lesson 2: Incentivizing banks in Ethiopia to participate in a blended finance intervention to unlock financing opportunities to SMEs in priority sectors requires more than a percentage***

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<sup>1</sup> Thebigdeal.substack.com by Max Cuvellier and Maxime Bayen

***payout for performance. Incentives need to be carefully designed to be attractive to stakeholders.***

In the best of times, banks in Ethiopia are unable to satisfy the high demand for loans and have little incentive to work with smaller, riskier businesses. Additionally, the Foreign Exchange (FX) problem continues to deepen. The national bank has a one-month FX reserve at best, and bank laws continue to become more restrictive. For example, there have been four directive changes in one year, with the most recent change requiring anyone bringing foreign currency into the country to surrender 80% of the amount to the National Bank (exchanged to birr immediately), further amplifying the liquidity challenge of the banking sector. The lack of FX also has a huge impact on business performance, reducing their production capacity due to their inability to acquire the necessary raw materials for production. According to Ato Asfaw Melese, the President of Dashen Bank, who attended the CATALYZE MS4G learning event, the bank has seen many businesses close or suspend operations over the past two years due to the lack of raw material alone.

Designing an incentive mechanism to entice banks to make financing opportunities available to SMEs operating in priority sectors, such as WASH (a sector they know very little about as WASH is dominated by NGOs and the government), required some adaptations, including offering incentive payments in USD, which is in high demand. During initial conversations with banks, few had an interest in participating in the program given the high operating cost and low incentive payment structure. When the design of the incentive payment was modified to offer payments in USD, financial institutions were more inclined to undertake the partnership process.

Other USD forms of financing are also in high demand and require the MS4G program to carefully design and develop demand-driven interventions. For example, most manufacturing companies in the Ethiopian agriculture sector need capital in USD to make necessary purchases of machinery if they are to grow their business. Considering long wait times to access Letters of Credit, SMEs suggested considering capital goods financing in USD, if one is to truly remove barriers to private sector growth and have a meaningful impact. The program will continue to adapt and further explore opportunities for capital goods financing mechanisms through the Development Bank of Ethiopia (DBE), including support of SMEs in loan restructuring as high default rates continue to plague the performance of the DBE.

***Lesson 3: Partners' / Service Providers' understanding of the market systems approach is critical.***

The Pause and Reflect session held with partner service providers under the Youth Programming component revealed that the market systems approach, more specifically the Pay-for Results (P4R) mechanism, was new to the Ethiopian context. It took time to convince market players to engage with the program within this framework. MS4G further emphasized educating its partners on the market systems approach and provided increased support to help them adapt to the framework. Given the steep learning curve and slow adaptation, a deep network and strong relationships with the financial sector and private businesses helped significantly in opening doors and getting the program off to a good start. In a very volatile and constantly changing environment, continuing to foster strong relationships with market players, listening to their challenges, and maintaining flexibility to adapt as a program team continues to be an important success factor.

## **DIGITAL TRANSFORMATION**

CATALYZE MS4G works to accelerate trial and use of digital solutions among local SMEs. Available digital services can help businesses improve operational efficiency and connect with customers for improved incomes and livelihoods. MS4G takes a systems approach to advancing Ethiopia's digital

economy, including fostering investment in digital enterprises and services/solutions providers for the WASH and food security sectors, encouraging SMEs to expand the adoption of digital solutions, and addressing policy impediments affecting digital transformation at the enterprise and sector level.

In Year 1, MS4G carried out a comprehensive Digital Landscape Assessment—the first of its kind in Ethiopia—to capture market conditions in digital finance, e-commerce, transport, sector-tech, and ecosystem service, with multiple workshops to disseminate findings and promote the digital economy as a business performance enabler, an area of growth for innovative firms. In Year 2, MS4G provided fintech training to 500 SMEs in the food security and WASH sectors and kicked off an accelerator program to support 100 growth-oriented early-stage SMEs in the food security and WASH sectors. Some of the learning that has emerged in the past two years include the multiple challenges of operating in secondary cities yet a need for MS4G to increase its regional activities to expand the digital ecosystem and its impact on business growth. Also, as there are a small number of women involved in Ethiopia's digital economy who address this, MS4G actively enrolled women-owned businesses to participate in MS4G's digital economy activity. MS4G will amplify its approach with more targeted interventions to better empower women in business through technology, including assessing the constraints and designing appropriate interventions that promote gender equity in the digital economy in Ethiopia. Finally, MS4G is proactively working to identify digital solutions that can be integrated and/or adopted by market actors across multiple value chains in the agriculture sector for improved productivity, market access, and food security.

In Year 3, MS4G will partner with one or more e-commerce platforms, such as Hello Market, to expand the number of SMEs selling agriculture and WASH products on their websites and incentivize digital solution providers through P4R to support SMEs as they work to adopt digital solutions to solve supply chain, financial management, or other challenges. MS4G will also look to partner with fintech firms to develop or expand the use of digital payment solutions for products and services, including payment solutions for WASH products and services, and consumer financing for the purchase of WASH products.

## **GENDER AND YOUTH INCLUSION**

Women and youth face particular challenges and structural inequalities that often constrain the growth of their businesses. The inclusion of women and youth is a central focus and crosscutting theme for all MS4G interventions. MS4G's MEL plan applies gender considerations and disaggregates data to measure outcomes and impact by sex.

For example, the Empowering Youth workstream seeks to better connect the supply and demand of labor and build the skills required by Ethiopia's workforce. Using a market-based approach, MS4G collaborates with private sector educational and technical institutions, youth-oriented organizations, and employers (e.g., industrial parks and tenants) to equip women and youth with the skills required to work in the private sector and create 77,000 jobs and youth-led businesses. To date, 13,811 youth program participants have been trained by six service providers with an average of 51% female participants. Additionally, 9,206 youth participants have obtained job placements of which 56% are women. While some success has been achieved in targeting youth, integrating gender considerations across program interventions needs further improvement to reduce structural barriers that prohibit or constrain women's economic participation. Women-owned firms underperform compared to their male-owned counterparts across several indicators: on average, businesses headed by a woman post 80% less revenue, as a result of household- and firm-level characteristics, such as women's time poverty due to competing obligations in the household and the sector in which the business operates. Data on firm profits is more difficult to obtain, but evidence from the Ethiopian manufacturing sector indicates that the average monthly profits of women-owned manufacturing

firms are about 45% lower compared to similar businesses led by a man. Additionally, the gap in access to the formal banking sector is increasing, looking at data between 2014 and 2017. (Buehren et al, 2019). Women comprise 46.8% of microfinance institution clients, but women entrepreneurs have difficulty graduating from microfinance institutions to commercial bank lending, which is characterized by high minimum loan sizes, higher interest rates, burdensome collateral requirements, and the “relationship lending” nature of the banking sector, basing credit analyses not only on borrowers’ repayment track records but their standing in the community, experience, and education. These factors work against women, who cannot easily penetrate the elite, male-dominated networks through which these relationships are built.

The team acknowledges the need to be more intentional with the design of project interventions and introduce new activities in Year 3 that directly address structural challenges faced by women entrepreneurs. The team is revamping its strategy with specific interventions and an action plan to achieve desired outcomes on gender. Some examples include a commitment to develop targeted briefs or talking points that make the business case for improved gender equality in the financial sector. The team will use evidence-based approaches to work with business advisory service providers (BASPs), transaction advisory service providers (TASPs), and financial sector partners to build their capacity in delivering services that promote the growth of women-owned SMEs (W-SMEs) in Ethiopia. The Blended Finance Activity, launched in Year 3, integrates gendered approaches, including larger incentive payments to banks for deals that are closed with W-SMEs.

## IMPACT (AS OF MARCH 2023)

<p><b>\$ 53.2 million</b> Capital mobilized (Debt and Equity)</p>	<p><b>19,625</b> Individuals placed in jobs (<b>63% of whom are women</b>)</p>	<p><b>15,895</b> Youth placed in jobs.</p>
<p><b>151 SMEs</b> Improved business performance</p>	<p><b>13%</b> Average increase in annual sales of firms that received technical assistance from MS4G-incentivized BASPs</p>	<p><b>631 SMEs</b> Received technical support/training to actively engage in the digital economy</p>

## RESILIENCE DURING INSTABILITY

The MS4G program operates in a constantly changing environment, requiring the team to regularly shift, pivot, and adapt program interventions. Within the first year of operation, the project almost shut down as geo-political tensions deepened between the US and Ethiopia, quickly followed by the war in Tigray, leading to the suspension of certain project activities and reduced budgets. The team quickly responded with a lean structure, placing new project hires such as a Deputy Country Director - Technical and Collaborating Learning Adapting (CLA) Manager on pause to reduce costs.

The war in Tigray and insecurity in the rest of the country has also had significant impact on business operations, disrupting supply chains, slowing enterprise and job growth, and instigating more cautious decision making on the part of investors, all of which negatively impact capital mobilization. From an operational perspective, the conflict resulted in security challenges that have limited the project’s (and its partners’) ability to operate in the region. MS4G was initially expected to establish multiple regional offices, including in Northern Ethiopia. Due to the conflict, MS4G has held off on opening the Mekelle office in Tigray as well as other offices. This affects MS4G’s ability to operate as a national project and serve a wide range of SMEs and stakeholders in a regionally inclusive manner.

Finally, the looming economic crisis, a lack of foreign exchange, high inflation, and a constantly changing policy environment create a less attractive environment for private sector investment, especially foreign direct investment (FDI). In the wake of FDI flight, the project sought to galvanize local investors and mobilize local equity investment for the first time, which was an important demonstration for the private sector at large. The program now focuses on longer-term investments, such as blended finance programs, taking the time to appropriately design and launch an activity with four banks and adapting the incentive mechanisms (e.g., payouts in US dollars). Other innovations and adaptations include exploring opportunities to partner with the Ethiopian Commodities Exchange, leveraging remittances from women working in the Gulf countries to increase access to finance, as well as tapping into local capital. The program also engages the Capital Markets Authority as well as the Nairobi Security Exchange to build confidence and secure a commitment from the Nairobi Exchange to invest in the newly-formed Ethiopian capital markets.

## NEXT STEPS



1. Moving forward, CATALYZE MS4G will continue to carry out rigorous MEL and CLA to contribute to a deeper understanding of the Ethiopian market systems and adapt programming in line with key findings and learnings. Further, MS4G will ensure MEL and CLA tools align with evolving program activities, provide quick data analysis, and promote CLA across all program areas.
2. The value of inviting program stakeholders to learn and reflect on program interventions has shown to be indispensable. The program will organize and create opportunities for regular exchanges, small group talks, and workshops, including space for networking and collaborating with one another.
3. The program will revise and implement a more robust gender strategy to ensure that the program continues to support and unlock barriers for women and youth.
4. The program will continue to explore creative opportunities to raise capital, such as from impact investors, angel investors, and diaspora investors who might be more tolerant of the current operating environment in Ethiopia. Those who invest in a cause they believe in often have a higher tolerance for risk; patient capital is worth further focus, even if the size of capital might be smaller.

**USAID CATALYZE (2019-2027)** is a \$250 million contract designed to mobilize \$2 billion in private capital towards underserved sectors, geographies, and populations across 27 countries in Africa, Asia, Latin America and the Caribbean (LAC), and Europe.

CATALYZE, implemented by Palladium, co-creates with Missions, Bureaus, and Independent Offices (MBOs) to design multi-year, results-based activities that are managed by Palladium and implemented by a broad network of principally locally led implementing partners.

## FOR MORE INFORMATION

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