



Analysis of the business environment in Least Developed Countries

Ethiopia

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voice for business

International Organisation of Employers | Organisation Internationale des Employeurs | Organización Internacional de Empleadores

Ethiopia

Region
East Africa

Population
120 283 026

Demographic growth
2.6%

Average income (2021)
925 USD

Human Development Index:
175 out of 191 countries. Ethiopia was 0.498 points in 2021.

Regional economic community
Common Market for Eastern and Southern Africa

Economic overview

In 2020, agriculture accounted for 35.45 per cent of GDP and 65 per cent of employment, the industrial sector contributed 23.11 per cent to Gross Domestic Product (GDP) and 10.35 per cent of employment, and the services sector contributed about 36.81 per cent to GDP and 24.3 per cent of employment to the labour market ¹.



The Ethiopian manufacturing sector is marginal in employment creation, exports, and output and is short of stimulating domestic linkages. The sector is dominated by small firms, resource-based industries, low-value and low-technology products, and weak inter-sectoral and intra-sectoral linkages².

Ethiopia has abundant renewable energy resources and has the potential to generate over 60,000 megawatts (MW) of electric power from hydroelectric, wind, solar and geothermal sources. Electricity demand has been steadily increasing, and the current access rate is 45 per cent (95 per cent in urban areas and 32 per cent in rural areas). Policies have been enacted to liberalise energy generation for foreign and domestic investors fully. Transmission and distribution of electric energy through the national grid are currently reserved for domestic investors only³.

The government has undertaken significant reform towards liberalisation and expanding private investment in the economy by relaxing the government monopoly on key sectors of the economy, telecoms, energy, and logistics, through partial privatisation of state-owned enterprises.

The government is the main driver of Ethiopia's information and communications technology (ICT) growth. ICT is one of the springboards towards achieving the country's vision in 2025 of becoming a middle-income country⁴. The government has licensed two privately owned telecommunication operator companies in this regard. They are expected to make over 40 per cent of the sales in the country. Once well underway, the ongoing liberalisation of the telecommunications sector is expected to usher in a new era for the rapidly evolving and mature ICT market, with new opportunities via partnerships with

¹ <https://data.worldbank.org/country/ethiopia>

² Oqubay Arkebe: The structure and performance of the Ethiopian manufacturing sector: African Development Bank Group, 2018.

³ Ashebir Dingeto Hailu and Desta Kalbessa Kumsa: 'Ethiopia Renewable Energy Potentials And Current State' (2021) 9 AIMS Energy.

⁴ Tafesse M: e al: Electricity regulation in Ethiopia: overview: Thomson reuter. 2020.

existing and new local players in both the consumer and enterprise spaces⁵.

Challenges faced by the private sector

- **Inadequate electricity supply:** Interruption and cuts in electric supply raise the cost of businesses in several ways, including through the need to pay idle employees during power cuts, loss of customers and market shares due to delays in production or service provision. Electricity demand continues to outpace supply as new hydropower dams struggle to produce at full capacity. Power transmission lines and distribution facilities are inadequate to the demand. The government is investing significantly in large-scale hydroelectric generation projects to double the current near 4000 MW power supply. If completed, these projects could meet domestic electricity demand and produce a significant surplus of power for export.
- **Inadequate skilled manpower:** Skills mismatch and inadequacy of skills in sectors such as agro-processing, horticulture, and tourism remain common⁶.
- Businesses experience a **lack of access to long-term industrial financing** for domestic firms due to the limited capacity of public banks and the lack of interest by private banks in such financing.
- The **lack of internationally competitive export logistics** and trade facilitation is especially important given that Ethiopia is landlocked is a key constraint on export-led industrialisation⁷.
- Importers face difficulty obtaining foreign exchange, particularly small and medium enterprises (SMEs). Firms face burdensome delays in arranging trade-related payments because the National Bank of Ethiopia (NBE) administers a strict foreign currency regulatory regime.

- **Customs clearance** remains a hindrance to imports – the clearance process is slow, and imported goods are sometimes charged at attributed values instead of invoice values.

- **The mechanism for contractual enforcement remains weak:** Delays in civil and criminal proceedings and the inefficiencies of courts in ensuring the enforcement of contracts are major problems faced by the private sector. Another problem regarding contractual enforcement is that commercial arbitration is largely inaccessible and expensive.



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- **Bureaucracy and corruption:** Businesses experience unnecessary bureaucratic procedures, excessive documentary requirements, procedural hurdles relating to poor institutional coordination among the different government offices, and inefficiency in government agencies and systems in the process of obtaining and renewing business licences, obtaining construction permits and all engagement with government institutions constitute a significant burden. The culmination of these challenges creates opportunities for corruption to fester. The government has introduced a new commercial code that is expected to be aligned with modern business structures and operations.
- **Low internet connectivity:** Mobile connections stood at 44.9 per cent of the total population, while internet penetration stood at 24 per cent in 2020⁸. This is low compared to other developing countries due to high mobile tariffs and the country's poor network coverage. While 2G networks are widely available, 4G coverage is restricted to Addis Ababa. Ethiopia

⁵ Hook, F. Ethiopia ICT Landscape and Future Market Opportunities. IDC, 2020

⁶ Tekleselassie, T. "The potential of industries without smokestacks to address unemployment." (2021).

⁷ Oqubay, Arkebe. The structure and performance of the Ethiopian manufacturing sector. African Development Bank Group, 2018.

also has a notably low level of international connectivity. E-commerce is in its infancy, rarely used, and mobile banking is growing⁹.

- **Inconsistencies in tax assessments and excessive penalties:** Unclear tax administration rules lead to discretionary practices by government officers. In this regard, it frequently occurs that financial statements submitted by businesses are unduly rejected, and tax assessments prepared by government auditors often inflate taxes payable since unclear rules are interpreted to the disadvantage of businesses and access to tax dispute resolution mechanisms is limited. The severity of penalties, lack of guidance on compliance, and the inefficacy of the tax authority in service provision and client handling, are major business challenges.
- **Low quality and infrastructure coverage:** the absence of effective transport solutions, including rail systems and road networks, is a major constraint to the private sector growth. Businesses face the challenge of low levels of rural accessibility and inadequate road maintenance, which impacts the cost and time of doing business, including access to markets.
- **Political instability and rising insecurity** pose a daunting challenge for the investment environment¹⁰.



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Private sector policy recommendations

- Allow for sustainable agriculture in Ethiopia to produce food and cash crops at least twice

a year, thereby expanding production from local consumption to export. The government can achieve this by collaborating with the private sector to build and enhance sustainable capacities of natural resources such as water and soil¹¹.

- Create a government initiative that supports financial institutions and local enterprises to develop a range of financial products that will enable young entrepreneurs to access the working and investment capital needed to expand operations and develop their businesses.
- The government should partner with the private sector in developing a continuum of on-farm, off-farm, and non-farm services, taking a spatial approach to connect rural towns and large cities and supporting entrepreneurs and micro-enterprises through incubation centres, industry clusters, and ecosystems¹².
- Ethiopia has a thriving leather shoe industry with more than 5,000 MSMEs that are generating over USD 65 million in exports and might have a competitive advantage in several other industries like tourism, textile and garments, cultural handicrafts, floral growers, and agro-processing. The government should increase access to low-cost financing, tax incentives and a favourable regulatory environment and support entrepreneurs by linking them to the global marketplace.

- **Government agencies should collaborate with firms and industry associations to develop joint initiatives to build and upgrade workers' skills.** Support schemes and incentives (such as government cost-sharing and loans) should be designed to promote skills and productivity in the private sector.

- The government should partner with the private sector in developing industrial policies

⁸ O'Dea S: Telecommunication penetration rate/density for Ethio Telecom: Ethiopia: Statista. 2021

⁹ ICT and Telecommunications in Ethiopia 2021. <https://www.researchandmarkets.com/reports/5414964/ict-and-telecommunications-in-ethiopia-2021>

¹⁰ Tekleselassie T: "The potential of industries without smokestacks to address unemployment." (2021).

¹¹ Yohannes Habteyesus Yitagesu: 'Land Evaluation: Sustainable Land Management And Impacts Of Climate Change In Agriculture; Ethiopia: Review' (2021) 04 International Journal of Multidisciplinary Research and Analysis

¹² Kelly L & Martinez J-C: Can Ethiopia Create 2 Million Jobs Every Year? Worldbank.(2018)

that go beyond the obvious manufacturing sector, with the key aim of promoting a faster shift of people and resources into high-productivity economic activity, which increasingly also involves some services and some agriculture¹³.



Government agencies should collaborate with firms and industry associations to develop joint initiatives to build and upgrade workers' skills.

- The government should engage the private sector in developing climate-smart agriculture (CSA) policies and training to help farmers manage their resources to protect ecosystems and reduce agriculture's contribution to climate change by promoting new methods and technologies.
- The government should engage the private sector in developing initiatives to connect small-scale farmers to lucrative food markets; this provides a powerful means to reduce rural poverty. It should ensure access to market information and provide training so that produce meets the quantity or quality of crops demanded by the market and that farmers can process and market their produce effectively.
- The government of Ethiopia needs to engage with the private sector in diversifying electricity production by licencing and providing tax incentives for the establishment of off-grid energy generation and distribution to solve energy problems in rural areas¹⁴. The government should seek private sector engagement in power development projects using Independent Power Purchase (IPP) agreements to sell power from renewable energy resources (geothermal, solar, wind and biomass).
- The department of information technology should encourage the development of the information and communications technology (ICT) sector by supporting private investments. This is possible through enacting policies such as tax holidays and eliminating strict regulatory measures for potential investors in software development, mobile telephony, internet and broadband, ICT hardware manufacturing, and assembly¹⁵.
- **The absence of mobile banking and other innovative mobile applications that support social and economic development has been one of the major setbacks to Ethiopia's ICT progress.** The opportunity cost will be high if concerted efforts are not made to create the environment for developing mobile applications. This can be done by forging, financing, and promoting collaborative partnerships with other countries in Africa, Asia, and Latin America, and linking local developers with the private sector.
- The government should exploit the tourism potentials of the Bale Mountains, the rift valley, and the Awash national park. This can be achieved through conflict resolutions in these regions.



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¹³ Oqubay Arkebe: The structure and performance of the Ethiopian manufacturing sector: African Development Bank Group, 2018.

¹⁴ Ashebir Dingeto Hailu and Desta Kalbessa Kumsa: 'Ethiopia Renewable Energy Potentials And Current State' (2021) 9 AIMS Energy.

¹⁵ Addisalem Genta Gemiya, 'Factors Affecting The Use Of ICT Services In Ethiopia' (2020) International Journal of Information and Communication Technology Education.

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