

Draft

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Entrepreneurship

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A Centre for Human Environment backgrounder for the National Consultations of the High Level Commission on the Legal Empowerment of the Poor. This is a more specific note on entrepreneurship in Ethiopia. The paper is undergoing peer review to ensure its representativeness of coverage of the main Issues the Commission is entrusted with.

Legal Empowerment of the Poor: Entrepreneurship

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Executive Summary

This paper was produced to enhance discussions about entrepreneurship in Ethiopia, which is one of the four focus areas of the High Level Commission on Legal Empowerment of the Poor (HLCLEP). Special emphasis was made on the informal sector and on Micro and Small Enterprises (MSEs) as they are the principal sectors that absorb the main stakeholders of the study, the Poor.

While a first introductory section describes the methodology used and gives a brief background on entrepreneurship in Ethiopia, a second section provides an overview of the informal market in Ethiopia. It is then followed by a third section about private sector development in Ethiopia, including a section about Micro and Small Enterprises, with the aim of providing a big picture about private sector initiatives in Ethiopia. A fourth section analyzes the impediments for the formalization of informal markets based on literature review, case studies, focus group discussions, key informant interviews and observations.

Based on the findings of this paper, the main areas for discussion to enhance the attractiveness of the formal economy to the informal sector and to enable the channeling of the creativity found in the informal sector towards the formal one are the following: access to land, premises, and working space; the instauration of a tax system that is less arbitrary and less subjective; adequate financial services; access to markets; access to private sector organizations as well as the establishment of formal or informal linkages and/or business cooperation amongst enterprises; the implementation of a clear and pragmatic national policy to enhance the development of the private sector and Micro and Small Enterprises; the development of entrepreneurial, managerial and other skills as well as the availability of skilled work force; the reduction of socio cultural constraints that hinder from taking private initiative; coordination among business development service providers; the reduction of bureaucratic red tape and other cumbersome regulations to enable easy entry and exit from the formal sector; the provision of adequate information about the procedures on becoming formal; and the betterment of the investment and private sector climate in Ethiopia in order to alleviate the overall mistrust between government, informal sector operators and private sector operators.

1.Introduction

1.1. Brief Background on Entrepreneurship in Ethiopia

Poverty in Ethiopia is both deep and widespread. With a GDP per capita of US\$ 100, it ranks at the very bottom of the world in terms of income. 89% of the Ethiopian population lives below the US\$ 2 per day poverty line and 46% below US\$ 1 per day. Over three quarters of the population of 70 million live in rural areas. Average life expectancy at birth is 43 years.

The economy is highly dependent on agriculture, which accounts for around 45% of GDP. Agricultural exports, notably coffee, qat and hides and skins, account for over 80% of all exports, with coffee as the country's chief foreign-exchange earner. Industry accounts for 11.1% of GDP and services 43%. The heavy dependence on agriculture makes the country extremely vulnerable to external shocks such as climatic conditions (drought) or commodity price fluctuations.

A long history of poor macroeconomic policies, economic mismanagement, protracted war, internal instability and recurrent drought are the main causes of the dire situation the country is now in today. These coupled with a high rate of population growth of around 2.9% per annum further contributed to the economic deterioration and the overall decline in the welfare of the society at large. The structural characteristics of the Ethiopian economy manifest themselves in the predominance of subsistence activities, narrow production base, neglected informal sector, environmental degradation, lop-sided development and weak institutional capacity.

The socialist regime which followed a centrally planned economic system since 1974 introduced excessive government interventions and controls that are to some extent responsible for the rapid expansion of the urban informal sector. Cumbersome rules and regulations, bureaucratic red-tape as well as excessive and costly administrative and legal requirements to obtain trading license have discouraged law abiding citizens in their participation in the formal sector and contributed to their operation in the informal sector.

To overcome the economic crisis in urban areas, urban dwellers resorted to various schemes depending on which group they were in. Some residents created various self-support schemes to survive, the major ones being trade in the informal sector. As the absorption capacity of the formal sector in Ethiopia is limited, the urban informal sector would assume even greater importance. This is in fact exacerbated by the fact that population growth in urban areas is around 3% per annum due mainly to rural-urban migration.

Most of the urban settlers in Ethiopia earn an income that barely enables them to survive. Considering the high living costs in major urban areas, most urban residents resort to informal sources to acquire additional income. The informal sector, therefore, has been an important source of supplemental income not only for the unemployed and destitute but also for the urban wage earners who found their salaries depressed as a result of the fall in real incomes.

As the socialist Derg regime implemented extensive nationalization of private property, the previously existing private sector almost came to a complete halt. This

led to a boom of informal sector activities. The informal market was marginalized and even brutally discouraged. After the change of government in Ethiopia in 1991, several policies were formulated and regulations promulgated relating to diverse social, economic and political issues. Policies and institutional developments that aim at providing minimum biases against the informal sector and also at stimulating various initiatives to support the promotion of the sector were adopted. The adoption of a comprehensive macroeconomic and structural reform led to the subsequent formulation and adoption of the Agricultural Development Led Industrialization (ADLI) through increased agricultural production, productivity and diversification. The most important policy reforms are the safety net program that provides support for those in extreme need and the provision of an enabling environment for private sector development. Other reforms in overall development policies, including decentralization, among others, have been made and will be discussed in the section regarding policies and institutional reforms.

Some of the informal sector activities in Ethiopia include: sale of perishable and non-perishable food items in the open market; residence based eating or drinking places where indigenous food and / or beverages such as "injera", "tella", "tej", "katikala" are retailed in fresh form; home based work shops of traditional artisans in weaving, shoe making and repairing, tailoring, hair dressing (both men and women), carpet making, pottery, basketry, embroidery; other activities such as wood carrying; sale of used and unused clothes in identified places in towns; small maintenance and repair shops for electronics; shoe shining, etc.

In general, volume of literatures reported the assenting role of the informal sector to operation of the formal sector in terms of availing opportunities from forward and backward linkages and there by contributing towards the development of the overall economy in terms of employment, output and other areas. These possible contributions of the informal sector are not usually milked without cost. Unless the manner and direction of informal sector activities are cautiously watched over, they may end up even in collapsing the very root of economic progress, the formal and organized sector. The threats of the informal sector on the operation and sustainable growth of the formal sector may be largely explained through unwise and unfair competition.

Those who subscribe to the notion that governments should intervene in the informal sector base their arguments on some mix of equity, efficiency or political economy principles. Those who make the case on equity principles argue that the poor especially women, who are concentrated in the informal sector face uneven market power and discrimination; have inefficient market information or skills, and inadequate insurance against risk. They argue that current process of informalization whereby more and more people are working under the informal arrangements threatens to do away with decades of social progress. As such, the need for a new contract between the state, business organized labour and other social actors is important and recommended.

The rationale for state intervention by some scholars is on efficiency principles. They argue that since informal sector contributes to GDP; produces large share of consumer goods, particularly those bought by middle and low-income groups, and generates significant employment opportunities due to the labour-intensive nature of technologies used, governments should intervene to promote productivity and growth of the informal sector. Finally, those who make the case for state intervention on political economy principles argue that governments do intervene in markets but

the outcome or impacts of such intervention depends on type of sector and the relative power of different economic actors.

Whatever, the basis of the argument might be there is a need for government intervention so as to promote economic growth and reduce pervasive poverty in an economy. The intervention should be designed in a manner that could shape the operation of the informal sector to be complimentary to the formal sector activities and capitalize on mutual benefits of both sectors. This requires exploring the objective realities of the country in terms of the extent and effect of the prevailing problem, its long term development perspective, the different alternatives and opportunities, the social and political economy and similar other factors.

1.2. Methodology of the Study

In order to produce current, updated and relevant information for discussion in the areas of focus of the High Level Commission on Legal Empowerment of the Poor, research, literature review, interviews of relevant actors, observations, discussions with stakeholders have been undertaken. Among those interviewed were government officials involved in the sector; representatives of the target groups i.e. the Poor through their representing civil society organizations and directly; microfinance institute representatives as well as private sector representatives.

We would like to thank the following entities for their cooperation with interviews of key informants and/or provision of relevant information:

- Government representatives from :
 - Ministry of Labor and Social Affairs (MoLSA)
 - Federal Micro and Small Enterprise Agency (FeMSEDA)
 - Central Statistical Authority (CSA)
 - Enterprise Ethiopia
- Microfinance institutions:
 - Specialized Financial and Promotional Institution (SFPI)
 - Association of Ethiopian Microfinance Institutions (AEMFI)
- Non-governmental organizations
 - Women in Self- Employment (WISE)
 - Pro-pride
- Representatives of the main stakeholders

Among representatives of stakeholders, the methodology used to acquire relevant information was: direct interviews of informal sector operators in Addis-Ababa, specifically in *Merkato, Piassa/MenelikII Square, Megegnagna* and *Cherkos* areas. Focus group discussions and interviews of the target groups were also held through their representing Non Governmental Organizations (NGOs) Women in Self-Employment (WISE) and Pro-pride.

The aim of this paper is to induce discussions on the following questions: How can the entrepreneurial innovation and creativity found in the informal economy be channeled into the creation of decent jobs within the formal economy? How can opportunities for establishing businesses be enhanced so that the poor (including women and youth) face fewer barriers to involvement in the formal economic

system? What are the specific needs and problems faced by those who conduct business in the informal economy and lack access to credit? How do complex business regulations or inefficient institutions prevent the poor from creating businesses or otherwise engaging in economic activities in the formal sector? What incentives can be created to increase access to finance and credit? How can the poor, as key stakeholders, be directly involved in the reform process?

Interviews and focus group discussions of the main stakeholders were conducted in the capital city Addis Ababa, which is the seat of the Federal Government. It covers an area of 21,000 hectares. The population of Addis Ababa is estimated to be approximately 3 million. Merkato is one of the biggest open markets in Africa. In addition to Merkato, there are four big open markets in the outskirts of Addis Ababa. Overall, Addis Ababa is the major terminal market in Ethiopia. Though these markets are open six days a week, each market has one major and one minor market day every week.

2. Overview of the Informal Market in Ethiopia

2.1. The Concept of "Informal Sector"

The Central Statistical Authority conducted a nation wide urban informal sector survey in January 2003. It defined the informal sector as

- home based or individual establishment/ activity operated by the owner with few or no employees;
- they are for the most part unregistered and operating on a very small scale and with a low level of organization;
- most of them have very low level productivity and income;
- they tend to have little or no access to organized markets, to credit institutions, to modern technology, to formal training and to many public services and amenities;
- A large number of them are carried out without fixed location or in places such as small shops, outlets or home-based activities;
- They are not recognized, supported or regulated by the government;
- They are beyond social protection, labor legislation and protective measures at the workplace.

To identify the households with informal sector operators, the CSA used the following criteria:

- At least one member of the household must be engaged in productive activity;
- Employment of the owner of the activity must be either an employer or a self-operated activity;
- The establishment/activity shall not be a corporate type of enterprise;
- The establishment/activity should not keep a complete book of accounts;
- Number of persons engaged (if any) including the operator must be less than 10;
- The establishment/activity should not be registered by any legal authority which gives licenses.

2.2. Current Status of the Informal Market in Ethiopia

In the past, the informal sector was considered as a transitional issue that would disappear quickly as more jobs become created as part of the development process. Therefore, data collection on its activities was largely ignored as development strategies were oriented towards medium and large-scale enterprises.

The informal sector in Ethiopia has flourished due to economic recession, high rates of population growth and urbanization as well as structural adjustment policies. The scope of poverty in Ethiopia, like in many other developing countries is the direct consequence of limited employment and income opportunities. Therefore, the population resorts to informal means to enhance employment and household income. It is thus not surprising that in Ethiopia, 50.6 percent of urban employed are in the

informal sector.¹ According to CSA statistics, in 1997, employment in urban informal sector was eight times higher than wage employment in the formal sector. Moreover, evidence suggests that informal sector activities have become a source of survival for an increasing number of the urban and peri-urban population. Sample surveys show that in less than a decade from 1997 to 2003, the number of people engaged in urban informal sector activities has increased by approximately 37% (See Table 1).

Table 1: Urban Informal Sector Employment Growth in Ethiopia

Survey period	Number of persons engaged		
	Sample size	Total	% female
1996*	13, 162	30,969	64.92
2003**	15,035	997,380	59.99
Change between survey periods (%)	14	37	8

Sources: *CSA and Ministry of Labor and Social Affairs (MoLSA), 1997; **CSA, 2003.

As suggested by Table 1, there has been a substantial increase in self-employment or wage-employment in the urban informal sector. However, despite its importance in number and as an alternative source of employment and income, its productivity is very limited. According to 1997 estimates, although the sector as a whole accounted for over 95 percent of total employment in such establishments, its relative share in gross value of production and value added for the same year was only 30 and 34 percent respectively.²

Explanations for the low productivity of the informal sector is partly found in the fact that it is dominated by a number of micro enterprise operators (see Table 2), who in search of subsistence income, sell anything by the roadside, door to door and open markets.

Participation in urban micro enterprises requires little investment except in time and energy of those involved. Most of the informal sector operators are involved in the sector mainly as a means of survival rather than for making profit.

Table 2: Structure of the informal sector in Ethiopia

Features	Micro enterprises	Small-scale enterprises
Number of establishments	584,913	2,731
Average capital (Birr)	3,528	38,354
Average employment	1.5	3.3
Spheres of activities	Manufacturing, petty trade, cottage and informal handicrafts	Food manufacturing, wearing apparels, woodwork and fabricated metals

Source: CSA in Berger and Afro-Consult and Trading. 2003.

¹ Statistical Report on the 1999 National Labor Force Survey. March 1999.

² Solomon. W. 2004.

2.3. Opportunities for Informal Sector Development

2.3.1. Policy and Regulatory Environment

A legal and regulatory framework that creates a conducive environment is crucial for the promotion and growth of micro and small enterprises in general. After the change of government in Ethiopia in 1991, several policies were formulated and regulations promulgated relating to diverse social, economic and political issues. These frameworks relate to the:

- adoption of market economic policy;
- decentralization of power and the formation of regional states;
- formulation of a policy on women;
- privatization programs;
- revision of the investment code;
- enactment of laws on establishing capital goods leasing companies (which provide an alternative option for access to credit);
- issuance of Proclamation no. 40/96, which regulates the business of micro-finance in the country;
- issuance of the National Micro and Small Enterprises Development Strategy in 1997;
- formulation of a new labor law;
- the issuance of Proclamation No. 33/98 to provide for the establishment of the Federal Micro and Small Enterprises Development Agency (FeMSEDA).

Following the examples of their counterparts in other developing countries, policy makers in Ethiopia have shown interest in promoting the informal sector as a source of income and employment growth. In terms of direct contribution to the development of the informal sector, the most important elements of the overall policy and institutional reform are the safety net program that provides support for those in extreme need as a result of the reform process, and the provision of an enabling environment for private sector development. Reforms in overall development policies including decentralization, market economy, agricultural development led industrialization, and human resource development and utilization have been undertaken. Moreover, a number of sector specific policy reforms and concomitant restructuring of regulatory institutions that may have directly or indirectly contributed to the process of creation of micro and small enterprises include:

- Deregulation of domestic markets and prices;
- Financial sector reforms;
- Trade liberalization;
- Launching of Technical Vocational Education and Training (TVET) program;
- The adoption of an industrial development strategy that emphasizes the need for strengthened informal sector as a promising way forward towards broadening the industrial base and local production structure
- Restructuring of the then Handicrafts and Small Industries Development Agency (HASIDA) and the establishment of FeMSEDA and ReMSEDA.

2.3.2. Development of Business Development Service Providers

In recent years, an increasing assistance in supporting the capacity building within public and private institutions that promote the informal sector has been observed.

- A considerable number of grassroots NGOs have diverted their assistance from relief operations to integrated development that typically includes activities toward the promotion and development of MSEs (e.g. WISE; ProPride);
- National development agencies and their international partners such as the ILO and GTZ are actively involved in the development and use of Training of Trainers (TOT) manuals for the provision of basic business skills training to informal sector operators;
- There has been a growing interest in the establishment of a network or a forum of entrepreneurs, organizations and support institutions concerned with MSE promotion and development;
- To advance entrepreneurs' access to credit for start up and operation capital, donors such as USAID/Ethiopia assist in the establishment and operation of loan guarantee schemes;
- The proliferation of micro finance institutions since the mid-1990s and the on-going efforts to establish and strengthen rural financial intermediaries

3.Private Sector Development in Ethiopia

3.1. Doing Business in Ethiopia

The challenges of launching business in Ethiopia are shown in Table 3 below. Whereas the procedures to start a business and the time are relatively low, entrepreneurs must deposit at least 1,083% of income per capita in a bank to obtain a business registration number, which is a considerable impediment to starting a business in Ethiopia. While all other indicators for Ethiopia are relatively more conducive to the creation of business compared to other sub-Saharan African countries, the time to enforce a contract (690 days) is relatively high and needs substantial improvement.

Table 3 : Comparisons of Business Environment in Ethiopia and Sub-Saharan Africa (SSA) (2006)					
Issues	Ethiopia	SSA	Issues	Ethiopia	SSA
Number of start up procedures	7	11.1	Time to enforce a contract (Days)	690	581.1
Time to start a business (Days)	16	61.8	Costs to enforce a contract (as % of debt)	14.8	42.2
Costs to register business (as % of income per capita)	45.9	162.8	Time to resolve insolvency (Years)	2.4	2.6
Minimum capital requirement (as % of income per capita)	1,083.8	209.9	Cost to resolve insolvency (as % of estate)	14.5	16
Procedures to enforce a contract	30	38.1	Employment laws index range (100 = very rigid, and 1 = very flexible and simple)	34	47.1

Source: World Bank. Doing Business. 2006.

The Ethiopian Government declared its investment policy through Proclamation No. 15, 1992, which was amended latter by Proclamation no.37/1996, and Proclamation No.36/1998. Regardless of an observable policy shift towards the development of the private sector, it has not been drafted and subsequently amended on the basis of the relative investment attraction capacity of the country in the face of fierce competition among countries for foreign direct investment, the country's urgent development needs and the potentials of domestic investors. Thus, despite subsequent revisions, the policy could not attract meaningful investment. Some of the limitations in this respect include the prohibition of foreign direct investment in certain segments of the economy such as banking, insurance, small-scale power plants, and small and medium scale operations of various activities, water, power, air transport, railways and postal services. The investment code denies incentives for enterprises investing less than Birr 250, 000, and this might encourage small operators to engage in the informal sector operation.

There are problems associated with business licensing and regulations procedures. Council of Ministers regulation No.14/1997, Article 20 (2a) and 22 (2a) of proclamation No.67/1997 required

applicants for business license to submit certificate of professional qualifications and statements related to commercial activity, health and sanitary conditions, environmental problems and safety measures from government institutions. The process requires traveling hundred doors, offices and signatories which are engulfed with insensitiveness, unresponsiveness, respect less, non-understanding, unqualified, disheartening, and confidence eroding.³

From the supply side, formal land transaction is in an absolute monopoly of the government. Under the land lease policy, the Government avails land in urban areas for a period of 5 to 90 years. Not only municipalities do not have a tangible inventory of vacant land for investment but also prices on the basis of auction and facilities are not usually ready. In a country like Ethiopia where investment is scarce, externalities and social benefits in terms of employment creation, foreign exchange earning and similar other factors should be taken into account in government decisions.

Without mentioning the complaints about its amount, the value added tax introduced to replace sales tax has already created problems associated with lack of clarity about its implementation and hinders the smooth transaction of activities. This is partly due to its imposition before adequate preparations are made with respect to improving the financial management recording of firms as well as their books of accounts and before developing the capacity of tax administration.

Liberalization measures in particular in terms of reduction of tariffs prior to the formulation and enactment of an industrial policy in order to benefit from the privileges provided by the WTO and COMESA clauses have already injured local enterprises that have not yet developed competitive capabilities. The policy could have addressed such issues as problems associated with technology choice, access to market information, inadequate access to financial resources and foreign loans, absence of sub-contracting policy between small and large and in particular informal sector operators and the formal ones.

Though not directly linked, inadequacy of infrastructure (road, banking service, electricity, telecommunication and other services), and problems associated with the efficiency of judiciary in facilitating smooth operation of private investment are serious impediments the solution of which could have greatly facilitated the development of the formal sector and facilitated the transition from informal to formal sector activities.

3.2. Micro and Small Enterprises (MSEs)

3.2.1. Definitions

Size of employment, capital investment or turn over is used as criteria to categorize enterprises along scales of operation and define micro, small, medium and large enterprises. This categorization is important for functional and promotional purposes to achieve the desired levels of development. In the case of Ethiopia, there is lack of uniform definition at the national level to have a common understanding of the MSE sector. While the definition by Ministry of Trade and Industry (MoTI) uses capital investment, the Central Statistical Authority (CSA) uses employment and favors capital intensive technologies as a yardstick.

The definition used by MoTI, which uses capital investment as a yardstick, has been developed for formulating micro and small enterprise development strategy in 1997. According to the MoTI:

³ Addis- Ababa Chamber of Commerce. 2001.

- Micro enterprises are those businesses enterprises, in the formal and informal sector, with a paid up capital not exceeding Birr 20,000 and excluding high tech consultancy firms and other high tech establishments.
- Small enterprises are those business enterprises with a paid up capital of above Birr 20,000 and not exceeding Birr 500,000 and excluding high tech consultancy firms and other high tech establishments.

On the other hand, CSA categorizes enterprises into different scales of operation on the size of employment and the nature of equipment. According to CSA:

- Establishments employing less than ten persons and using motor operated equipment are considered as small scale manufacturing enterprises.
- Enterprises in the micro enterprise category are subdivided into informal sector operations and cottage industries: Cottage and handicraft industries are those establishments performing their activities by hand and using non power driven machines. The informal sector is defined as household type establishments or activities, which are non registered companies and cooperatives operating with less than 10 persons. All enterprises employing ten or more workers are grossly considered as medium and large enterprises.

In light of the above definitions and taking into consideration the Ethiopian situation, micro, small and medium enterprises (MSMEs) may be defined in the following way:

- Micro enterprises are business activities that are independently owned and operated, have small share of the market, are managed by the owner and employing five or less employees. This has recently been revised to include employment until 10 workers and capital reaching up to 20,000 birr.
- Small businesses are those enterprises that employ 6 to 49 employees. They share the same characteristics with micro enterprises in other aspects.
- Medium scale enterprises are those enterprises which have a relatively higher share of the market, are independently or jointly owned or managed by the owner or by appointed executives and employ 50 to 99 persons.
- Those enterprises that employ more than 100 persons could be considered as large enterprises.

Nevertheless, there is lack of clarity, inconsistency, lack of organized information and consistent historical data is lacking in Ethiopia. The features that distinguish MSEs from larger scale enterprises include greater owner influence, dominance of one person, more subjective decision due to centralization of decision making, close contact of the top management with employees at lower levels and greater concern with financial matters due to difficulty of attributable funds etc.

Clusters under the umbrella of MSEs are numerous activities – street vendors, shop keepers, hotels, bars, shops, groceries, hairdressers, wholesale and retail traders, export import traders and small scale industries etc. Most of these enterprises in the country are largely confined to trade and services and to small scale manufacturing and handicrafts, which constitute an important subset of small scale enterprises (SSE). The definition of small scale industries adopted by the Federal Micro and Small Enterprises Development Agency (FeMSEDA) in proclamation 124/77 is as follows:

A small scale manufacturing activity and engineering service establishment is a manufacturing establishment -except handicrafts- which has a fixed location within urban center; uses either manually operated machinery and equipment motive power driven machinery and equipment and engaged in the mechanical-chemical

transformation of substances into new products and in the fabrication, assembly, reconstruction, alteration and repair activity; employs at least one person other than the owner/owners, unpaid family workers and/or apprentices; and has fixed assets of value not exceeding birr 200,000 excluding investments made on land and buildings.

3.2.2. Overview of the MSE Sector in Ethiopia

In most fast developing countries, MSEs by virtue of their size, location, capital investment and their capacity to generate greater employment have proved their powerful propellant effect for rapid economic growth. The sector is also known as an instrument in bringing about economic transition by effectively using the skill and talent of the people without requesting high level training, much capital and sophisticated technology. Moreover, they create job opportunities for a substantial segment of the population. Hence, since the sector is a quick remedy for unemployment problem, direct intervention and support of the government is crucial to facilitate the environment for new job seekers and ease self employment.

One feature of the Ethiopian private sector as a whole is that it is highly dominated by micro and small enterprises, which are geared towards satisfying the needs of low income groups. Micro and small scale enterprise sector, accounting for the bulk of non agricultural economic activities, are highly concentrated in the production and consumption of textiles, food and beverage processing.

According to the survey conducted by CSA in 1997, within the MSE sector, micro enterprises (handicraft and informal operators) account for 99.8% of total establishments, 99.6% of employment and 94.7% of gross value of production and 95.1% of the value added. Small scale manufacturing industries (SSMI) are mainly engaged in the manufacturing of food, fabricated metal, furniture and wearing apparels, which constitute more than 85% of the SSMI.

Most MSEs are characterized by ease of entry and constitute the bulk of the population. Most of them are located in rural areas and lack access to basic infrastructure and lack formal technical education. It is well known that MSEs constitute the bulk of the private sector in Ethiopia which is the place for market economic system that can ensure success to the reform programs that the country embarked upon.

3.2.3. National Strategies for the Development of MSEs

The Government recognized the contribution of the informal sector. It has recognized and paid due attention to the promotion and development of MSEs for they are important vehicles to address the challenges of unemployment, economic growth and equity in the country. To this effect, it has formulated a National MSE Development and Promotion Strategy in 1997, which enlightens a systematic approach to alleviate the problems and promote the growth of MSEs. The overall objective of the strategy is to create an enabling environment for MSEs, with specific objectives to facilitate economic growth; bring equitable development; create long-term jobs; strengthen cooperation between MSEs; provide the basis for

medium and large-scale enterprises; promote export; balance preferential treatment between MSEs & bigger enterprises.

The strategy targets support measures and beneficiaries such as small manufacturers in food, textiles, leather, clothing metal works, and crafts; self employment (focus on school leavers, disabled and unemployed youth); start-up and expanding firms (focus on women-owned); small enterprises in nomadic and disaster areas; agro-business and small scale farming and fishing; small builders/contractors; small exporters; as well as small-scale tourism operators.

Among the MSE support framework, the strategy focuses on creating and implementing an enabling legal framework as well as on streamlining regulatory conditions by establishing an user friendly environment for the simplification and standardization of documents such as business registration and licensing; financial and loan application; purchasing and sub-contracting (tender) document; export documentation and other commercial documents; registration of contracts with municipalities; authentication of contracts at notary public; and simplified tax declaration forms for small businesses.

Other specific support areas and programs in the strategy include the facilitation of access to finance; incentive schemes; encouraging partnerships, training in entrepreneurship, skills and management; facilitating access to appropriate technology, access to market, access to information and advice, access to physical infrastructure and the institutional strengthening of private sector associations and chambers.

While the strategy clearly stipulates that the provision of meaningful supports require the vigorous and synchronized efforts of the various development actors including government bodies, non-governmental organizations, business associations, private enterprises, foreign agencies and similar others, Government has been setting-up Federal and Regional Micro Enterprises Promotion Agencies aiming at providing the above services and coordinating efforts of the various stakeholders. Even though, it might require substantiating with figures and facts, these efforts are not only inadequate but also fragmentary or uncoordinated.

Moreover, the strategy does not address the informal sector and promotional measures do not target it. Mechanisms to link the two sectors do not exist.

3.3. Challenges for the Expansion of MSEs

Most MSEs face critical constraints both at the operation and start up level. Some of these constraints include lack of access to finance, lack of access to premise, lack of infrastructure, lack of training in entrepreneurial and management skills, lack of information on business opportunities, social and cultural facts, in particular deficient entrepreneurial culture and excessive corruption.

Lack of clear and pragmatic national policy to enhance the development of MSEs – Despite the strategies such as the above mentioned and other rules and regulations that are in vigor in theory, most interventionist policies regarding MSEs are inappropriate and impractical. For instance, most government policies have a

tendency to over regulate and limit the growth of private sector enterprises and they are over bureaucratized and unfriendly to support small businesses.

Lack of access to capital and credit – Lack of adequate investment capital, lack of sufficient loan, inefficient financial market in terms of facilitating financial resources to entrepreneurs are the major obstacles in doing business, particularly in the informal sector. Most micro and small enterprises are highly risky ventures involving excessive administrative costs and lack the experience in dealing with financial institutions and do not have a track record of credit worthiness with banks. Since most banking institutions are reluctant to provide small enterprises with loan and credit, most MSEs are unable to secure collateral requirements. As a result of absence in financing, the creation of new enterprises and the growth and survival of existing ones will be impeded. Access to finance is a major bottleneck for the rapid growth and development of MSEs mainly due to targeted mechanism put in place to address the financial needs of small scale enterprises. Most micro and small enterprises do not have access to micro finance institutions and most banks are reluctant to avail credit facility to small enterprises unless they have acceptable collateral. The standard of loan appraisal, the long delay the banks takes to sanction loans, unfavorable disposition towards small loans and the limited collateral requirement, which is over 100% of the loan amount, are the major obstacles that small scale enterprises are facing at present. Moreover, the interest rate by most micro finance institutes, which is higher than the lending rate of formal banks, inhibits the effectiveness in addressing the needs of micro enterprises.

Lack of premise and land- For MSEs, lack of premise is unquestionably a serious problem. Most informal operators do not get access to suitable locations where they can get easy access to markets. The issue of acquisition and transaction cost has become very prohibitive to the emergence of new enterprises and to the growth and survival of existing ones. The issue of land provision and the land lease system has greatly constrained the chances of micro, small and medium enterprises who aspire to start up businesses.

Lack of entrepreneurial, managerial and other skills – There is a general lack of knowledge entrepreneurial and managerial capacity and marketing experience. Lack of skilled labor, which in turn leads to problems in production due to the unfamiliarity of workers with rapid changing technology, lack of coordination of production process, and inability to troubleshoot failures on machinery and/or equipments is a critical problem that MSEs are facing since they cannot afford to employ specialists in the fields of planning, finance and administration, quality control, and those with technical knowledge. Moreover, MSEs lack resources required for Research and Development and there is inadequate technical and entrepreneurial skills.

Lack of sufficient marketing and promotional support – There are no sufficient institutional facilities that nurture the promotion, growth and development of MSEs. Marketing their products effectively as well as accessing and acquiring information on business opportunities are the major bottlenecks that small and micro entrepreneurs face all over the country. As a result, the design and quality of products of MSEs are below standard. In addition, lack of marketing skills, weak infrastructural facilities renders small businesses to be uncompetitive.

Lack of skilled workforce - The most common form of acquiring skills in the MSEs sector is through apprenticeships. Though the formal education system prepares

students for paid employment, there are very few vocational institutions that cater for developing skills. This inevitably leads to low level of innovation in almost all sectors of the economy, severe shortage of training opportunities for potential entrepreneurs.

Socio cultural constraints - The following socio cultural problems are considered affecting the development of MSEs in Ethiopia:

- Lack of enterprise culture in the country, which required a drastic change;
- Considerable lack of positive attitude in the country;
- Excessive corruption, which actually constrain private enterprise

Arbitrary and subjective tax system - Most MSEs, particularly the small scale operators, are subject to subjective tax system as most of them do not have a proper accounting system. Taxation are based on estimation of earnings and are highly subjective. Moreover, small scale operators face higher water and electricity tariff.

Lack of formal or informal linkages or business cooperation amongst enterprises -The other factor that hinders growth and expansion of MSEs is the effectiveness with which they interact with large or similar firms. In other words, formal and informal linkages or business cooperation through networking are not common. Large public enterprises and the few foreign affiliates do not outsource some of their operations to local MSEs. The legal and institutional mechanisms to enforce contractual obligations and government policy to design appropriate incentive mechanism to encourage the expansion of business linkages/sub contracting managements is at its infant stage.

In addition high taxes, choices of location, complexity of national laws and bureaucratic and cumbersome regulations, escalating interest rates and inflation hinder the creation and sustenance of MSEs.

The development of MSMEs requires concerted efforts on the parts of all government institutions. In this regard, issues related to tax, information and availability of working premises need to be addressed to facilitate the development of MSEs. While national policies play an important role in the development of MSEs, targeted interventions are much more effective to bring about a rapid change in the growth of MSEs' support services at the firm level. These are important mechanisms to ensure efficient allocation of resources by MSEs for them to grow and expand their operations. The promotion of MSEs needs to aim at creating a robust and dynamic private sector. There should be enhancement of enterprise growth and excellence. MSMEs tend to be driver motives of survival rather than technological upgrading and growth.

4. Findings and Observations on Impediments for the Informal Sector to Graduate to the Formal Sector

4.1. Case Studies of Street Vendors

Interviews were conducted in Addis Ababa in the areas of *Merkato*, *Piassa/MenelikII Square*, *Megenagna* and *Cherkos* areas. Informal sector operators were chosen at random. The street vendors interviewed were predominantly young male between the ages of 15-35. Regarding, their marital status most of them were single but they live in a family of on average 6 dependents and have no other sources of income. The status and nature of their employment before joining the informal sector ranged from being unemployed to private and public sector employee. The reported education level of the participants varied from primary to secondary levels with mean level of schooling being grade 6 complete which could hardly allow for qualifying for formal sector employment.

As an example, Shiferaw Merara is an ex-soldier from the Derg army and used to work in Djibouti. For the past ten years, he has been selling watches in Merkato to make a living since he does not have retirement money from his previous employment. He supports five people and earns approximately 10 Birr a day. Since he's not legal, he faces harassment from the police on a regular basis. When asked about the reasons why he has not graduated to the formal sector since he faces all these problems from the police, his replies were: "I do not have the courage and the motivation to change my career as there are so many barriers such as bureaucratic rules and regulations, financial problems, access to land, family problems as well as socio economic and cultural problems." He said that he would be "the happiest person" if he graduated to the formal sector. His main problem was not the fear of taxation but access to land and premises for him to work. The only place where the government allowed him to work was in an area where the market demand for his business was very low. He complained that the government did not give recognition to the informal sector as much as they should. Although some informal sector operators organized themselves in weredas and kebeles, there is no access to credit and they are not legal entities yet.

The costs of being informal are not few. Among those cited by the interviewees were:

- The fines and penalties they have to pay each time they are caught by the police (from Birr 25 to 75 each time);
- Not being able to claim possessions that are lost or stolen;
- Lack of security;
- Lack of access to capital

Most of the interviewees admit that they have very limited knowledge if at all about the various business rules and regulations governing the formal sector.

The motivation behind most informal sector businesses is generally assumed to be a survival issue, as opposed to return on investment. Although this sector composes

rich and poor operators, most of these businesses provide a subsistence existence. Returns tend to be low and intermittent, security and stability are minimal; working hours are long, and working conditions are poor usually with fear and frustration from police harassment. Thus, the scope and importance of informal activities will tend to parallel the levels of poverty and underemployment. The average volume of activities per month per informal operator is estimated at Birr 3,000-4,000 and the average income they generate is less than Birr 300 per month. The types of commodities sold out by the street vendors include new and used clothes and shoes, electronic gadgets and other household items that are made of plastic.

Asked what the difference was between the items sold by formal operators and themselves they say that the difference is only in prices. In most cases, the source of supply for both the formal sector operators and the informal sector operators are the same, namely the formal sector operators engaged in whole sale activities. According to the some of the interviewees, it is very rarely that the commodities they sell come through illicit trade channels. It is sometimes cheaper for the licensed importers to distribute their goods to informal operation outlets than the formal ones as they save the costs of formal operation. The costs of formal operation include rent, taxes, labor, storage and promotional activities. All these costs are avoided when they sell to informal operators. Asked who their major consumers were, they responded that the low income groups are their market. Especially in the case of used clothes/shoes, it is the low income group that makes use of informal sector opportunities.

The choice of informal sector operation primarily lies on the fact that it has relatively less entry barriers, it requires low capital, and it is flexible. One can switch among various possibilities once he/she is in the informal sector. It was also reported by the interviewees that their pick time of market is at the end of every month when most employees collect salaries. Though there is no separate or special day for selling their products for most of them, late afternoons to evenings are usually good time for them in that it is rush hour and they could easily find students and public and private sector employees coming out of work. They also disclosed that when customs authorities sell out confiscated items which were illegally imported, it gives them good opportunity. Aggressive government measures on contraband goods threaten their existence. Forceful measures and harassment by the policemen highly threatens their operation. However, informal sector operators believe forceful action of the government is neither justified and fair nor effective in addressing the problem. In fact it was explicitly stated by the respondents that it has been customary for them to give money to the police men so that they could allow them to sell out their items on the street.

An interesting finding is that most of the people interviewed reported that their operation is justified since there are no alternative given the lack of employment opportunities. Operating in this sector is the only means they found as a way out of their social and economic problems. They believe that the informal sector should be seen a mechanism on how people cope during hard times and represents a hand to mouth existence for many young people and their families. The informal sector reflects the survival strategy of the poor, those who have no access to formal employment or have no jobs or income or any kind of social protection or security schemes. The failure of the formal system to overcome poverty, inequality and unemployment is the major cause for the birth and growth of the informal sector. For most of the informal sector operators, the informal sector does not exist in isolation from the formal sector but on the contrary it is an essential part of modern patterns of production and rooted into the economy. The competition to reduce labor costs

and to find more "flexible" production methods results in a restructuring of the formal sector by subcontracting part of its production and trade to the informal sector. It provides jobs, income and livelihood for masses of workers who would otherwise have no alternatives and can in such way contribute to the market of the formal sector products and services.

The problems of petty traders are multifaceted, the major ones being the following. They work along roads, with no shades-exposed to rain, sun, traffic incidence, and harassment from police. House rents are very high. Either due to lack of information about micro credit, or inadequacy of loans, they suffered from working capital. They do not have access to training on basic book keeping principles and employable skills, so they usually fail to be flexible to change their business areas in times of crises and operate on the basis of a conscious profit maximization motive.

4.2. Focus Group Discussions

Focus group discussions were held with beneficiaries of two Non-Governmental Organizations (NGOs) operating in Addis Ababa: Women in Self-Employment (WISE) and Pro-Pride.

4.2.1. Beneficiaries of WISE

WISE was established in 1995 and strives to help poor, self-employed urban women increase their income, improve their line of trade, and create better employment opportunities.

Focus group discussions were held with the beneficiaries of WISE in two areas (Kebele 50 and 51) which are collection centers of savings or credit money provided by WISE. The groups were comprised of 10 women each. Beneficiaries of WISE are women between the ages of 25-60. Most of them are married and have children. Although they are not the sole breadwinner in their family, most of them have to support 6 or 7 members of the family. Most of the women make their living by selling different perishable indigenous food items such as *enjera*, *tella*, traditional bread, *berbere*, *shiro*, onions, yoghurt, butter, cottage cheese and so on. Most of them are home based although sometimes they sell on the streets. The income they earn only enables them to carry out their day to day activities. On average, their daily income is less than 5 Birr. Asked about the main impediments that deterred them from becoming formal, most of the women cited primarily lack of access to land or space to conduct business. All of the participants agreed that should the government provide them with space and land, they were willing to do "anything" even paying taxes which they perceive as a "duty" to their country. Their other major problem is access to capital due to the high and rising cost of living. Most of the participants are not aware about the rules and regulations or about the taxation system. However, the testament of one woman, Ms. Askale Bedane, amongst the participants highlighted the inadequacy of the taxation system. While undertaking her informal business from home- selling injera, traditional bread and other items- she was forced by kebele officials to become formal as they threatened to close her down if she did not comply. She registered her business and acquired a business license, for which procedure was relatively simple in terms of number of procedures

but not in the amount she had to pay for the business license. However, after becoming formal, she hardly made even and was forced to close down her business because the tax she was required to pay was astronomical. The taxation system is subjective as it is by estimation since business owners do not have proper accounting systems. Ms Askale claimed that they estimated her tax based on the type of furniture she had at home. She switched back to the informal business to make ends meet.

Most beneficiaries of WISE are part of the credit association provided by the NGO. They are given trainings on how to manage, save and spend their money in a proper manner. They borrow 500 Birr in the first round, 1000 in the second round, 1500 in the third round and so on. They complain about the bureaucratic system governing the business environment and it requires a lot of money to get the business license. These women choose the credit system offered by WISE as opposed to Micro finance institutions mainly because of the low interest rate offered by WISE.

4.2.2. Beneficiaries of Pro-Pride

Pro-Pride is an Ethiopian indigenous NGO committed to eradicating poverty by empowering the poorest of the poor. It was established in 1995 and currently works in Merkato, the most densely populated and poverty ridden market area of Addis-Ababa.

A focus group discussion was held with beneficiaries of Pro-Pride. It was comprised of 8 people (7 women and 1 man). They earn an income by selling perishable food items such as eggs, yoghurt, injera, cottage cheese, berbere, shiro, etc. They organized themselves in cooperatives (maheber). The total number of people in the cooperative is 50. They were given land eight months ago by the Government through the lobbying of Pro-pride. It took 4 years after they organized themselves into cooperatives to acquire land. Some members of the group are also involved in cleaning services. Prior to working in this organization, most of them were unemployed. Some participants admitted to resorting to other sources of income (in the informal business) to make ends meet as the sale of "injera" is not profitable due to the recent inflation and the rise of the price of "teff", the main ingredient for making injera.

The cooperative acquired a business license in approximately ten days for "Hibret Fana ye Shemanewoch Maheber", which can be translated as "Weavers' association". The renewal process took them 3 months. When they decided to change the name to "Ye Hibret Fana Baltina Maheber", as the former was inadequate and the latter more appropriate, they faced so many bureaucratic hurdles that to date, after several months, they still have not received the approval from the appropriate authority to acquire the business license. Without the official name change, they are unable to acquire an official stamp, or get credit or even withdraw the meager sum they have in the bank.

The other problem stated by the beneficiaries of the region is that the government does not provide basic necessities such as water and electricity. The people are willing to pay for the fees, taxes, etc but public officials are reluctant and irresponsible. Despite the fact that they are frustrated and desperate about public officials' irresponsibility and inaction, the beneficiaries have a future long term plan

of expanding their business. They are planning to open up a place where construction workers of the region come and take shower. They have also a plan of expanding their branches.

As can be noted from the cases of these target groups, motivation and initiative is highly impeded by lack of working space, lack of working capital, lack of training and unfavorable rules and regulations.

4.3. Key Informant Interviews

Interviews were conducted with key informants from: Federal Micro and Small Enterprises Development Agency (FeMSEDA); Enterprise Ethiopia; and Specialized Financial and Promotional Institution (SFPI). When asked about what were the main impediments that hindered informal sector operators from graduating to the formal sector were the following:

- **A taxation system that is perceived or is really excessive, subjective and discouraging-** For personal taxes, the first 150 birr earned per month is tax-free. Salaries and wages above 150 birr are taxed progressively at rates of 10% to 35% (the latter applies at 5001 birr per month and above). Transportation allowances, medical treatment expenses, travelling expenses and insurance premiums provided for in the employment contract are deductible insofar as they constitute a reasonable proportion of total income.
The main problem is that the taxation system for MSEs is subjective as MSEs do not have a proper accounting system. Public officials in kebeles grossly estimate the tax to be paid and are based on highly subjective criteria. Most of the business owners are forced to close shop when asked for exorbitant taxes. This creates and exacerbates mistrust between government officials and the private sector and has a negative impact on development and poverty reduction. Among the proposals made by some of the informants was to:
 - Introduce a taxation system for the poor in the informal and MSEs that is a lump sum of Birr 100 or 200;
 - Income should be considered as a household income depending on how many individual are included, therefore the income tax should take into consideration the number of individuals living in the household.
- **Lack of Access to Land and Premises -** The availability of plots of land and premises in strategic areas for the informal sector and MSEs in general to produce and market their products is essential. Lack of appropriate premises tends to force entrepreneurs to operate their businesses from home or resort to unsuitable and sometimes unsanitary conditions. Policemen are known to harass some of the entrepreneurs when they attempt to operate on street corners.
- **Lack of Co-ordination Among Business Development Service (BDS) Providers-** In spite of the establishment of FeMSEDA at national level and the ReMSEDAs in some of the regional states, there is lack of co-ordination among the various actors in the provision of BDS in the country. This has tended to result in the fragmentation and sub-optimality of various efforts as well as ad hoc interventions, sometimes encouraging rivalry between projects and institutions. In turn, this may result in the low impact of projects and inefficient use of resources, especially in terms of the sustainability of activities and programs.

Furthermore, in most cases business development services are donor or supply driven in nature; that is, they do not emanate from the perceived needs of the relevant target groups in the BDS market. This is often caused by the type of approach mounted by the service providers, which is donor or supply driven instead of demand driven, and exacerbated by the limited capacity of the service providers.

- **Limited Response by Financial Institutions** - So far conventional banks have not proved to be a suitable form of finance for MSEs, much less for those that are informal. This is due to a number of reasons.
 - The commercial banks in Ethiopia are not keen to extend credit to MSEs because of the small size of individual loans and the high cost of administering many small loans.
 - MSEs cannot put up the collateral requirements of banks.
 - Branch networks are generally limited to urban areas.

As things currently stand, micro-finance institutions (MFIs) are the only formal institutions that are accessible to microenterprises, also to those in the informal sector. In fact, microenterprises are largely the exclusive concern of MFIs, who do not finance small enterprises at all. Though micro-finance institutions have been striving to expand their outreach, both in terms of the area and size of clients, their loan product development capacity is limited. A recent report by the Association of Ethiopian Micro-finance Institutions⁴ asserts that the loan products of the MFIs in the country are supply-driven and are offered to all clients in a generic manner, without targeting specific needs or requirements. These standard loan products do not in many cases suit the particular needs of all sizes of MSEs. However, MFIs are principally funded by donors who to a large extent dictate the allocation of resources. Poverty reduction is often their primary objective, and donors work to ensure that the bottom layers of the population have access to credit so as to eventually earn their own living. Furthermore the credit delivery modality of MFIs is generally group-based. This is done to overcome the problems associated with the inability to put-up individual collateral for individual loans. However, as the financial profiles of clients develop, the group system may not, for various reasons, continue to be practical, useful or relevant. The MFIs as they operate now however, are not ready to design and implement alternative systems of collateral in order to meet the credit needs of such clients.

- **Easy entry and easy exit from the informal sector as opposed to realities of the formal sector** – As noted in a previous sector about doing business, while it takes 16 days in average to start a business, the exit is not easy. From interviews of key informants, it was learnt that in order for someone formally registered to exit, it can take more than three or four months during which time the entrepreneur cannot venture in another business. This is mainly due to the lack of capacity of the relevant ministries mainly the Ministry of Revenue to quickly assess the amount of tax due or other relevant information. There is serious lack of human resources and lack of data management system. There is a great need to build the capacity of ministries in service delivery. Otherwise, procedures and bureaucratic red tape becomes so cumbersome that they are discouraging and frustrating.

⁴ AEMFI. 2002.

- **Inadequate or lack of awareness or information about the procedures on becoming formal** – Although public officials in kebeles and weredas are in principle given the appropriate training to provide information about the procedures on registering business and other processes to become formal and also to extend business development services such as counseling, training, giving credit options to entrepreneurs, this is hardly implemented due to inefficiency, ineffectiveness and corruption of public officials.
- **Overall mistrust between government, informal sector operators and private sector operators**– There is a general mistrust, fear and perception that the government is against entrepreneurs. This has to do with good governance issue.
- **Low Levels of Education** - Low educational levels are characteristic of entrepreneurs who operate survival level enterprises, especially women. Unless interventions are directed at youth and school-leaving students, the existing, traditional enterprises will not move up or graduate to the upper end of MSEs. Young people, owing to their better education, can be guided, retrained and redirected so as to become more productive and growth-oriented entrepreneurs.
- **Lack of Market Access and Market Information** – Informal sector operators and microenterprises face serious difficulties in marketing their products or services. Research has revealed that this problem is often caused by the fact that these entrepreneurs produce and try to market their products around the homestead, thereby limiting their market to individual buyers or the immediate neighborhood. Often, such practices stem from lack of information about market opportunities or access to markets. It is essential that the marketing of products be linked to quality, price and timeliness of delivery of goods and services.

5. Conclusions and issues for discussion

As the aim of this paper was to induce discussions on the following questions such as how to channel the entrepreneurial innovation and creativity found in the informal economy to the formal economy; how to enhance opportunities for establishing businesses so that the poor (including women and youth) face fewer barriers to involvement in the formal economic system; what the specific needs and problems faced by those who conduct business in the informal economy and lack access to credit are; how complex business regulations or inefficient institutions prevent the poor from creating businesses or otherwise engaging in economic activities in the formal sector; etc.

In order to promote the informal sector and help it graduate to the formal one, and particularly to solve the key problems of the sector, the paper has highlighted the following issues for discussion:

- 1) **Access to land, premises, and working space** - As this issue has been identified as one of the most pressing problems facing the informal sector operators, discussing the expedition of the establishment of government policy on land for the sector, outside the lease system, is important. The issue of acquisition and transaction cost has become very prohibitive to the emergence of

new enterprises and to the growth and survival of existing ones. Since this will take more time, discussions should be held on short-term solutions, such as making land and premises available temporarily. The issue of land provision and the land lease system has greatly constrained the chances of micro, small and medium enterprises who aspire to start up businesses.

- 2) Arbitrary and subjective tax system** – Small scale operators, including informal sector operators and MSEs, are subject to subjective tax system as most of them do not have a proper accounting system. Taxation are based on estimation of earnings and are highly subjective. Moreover, small scale operators face higher water and electricity tariff.
- 3) Adequate financial services** - It is increasingly recognized that lack of credit is one of the most important problem facing informal sector operators. Discussions should be held on how the government organs should create proper policy environment, based on sound information, for the proliferation of micro-finance institutions (MFI). It is also important to redesign and modify the existing credit system of MFIs so that informal operators can easily access them. Discussions should also be held on how MFIs could channel their services to informal operators by providing small, short-term loans with gradually increasing amounts to allow business expansion and putting in place sound financial reporting systems. Possibilities about the provision of support by the Commercial bank of Ethiopia to MFIs by providing loan for financially sound MFIs so that they can increase credit to informal operators should also be discussed.
- 4) Access to Markets** - In order to alleviate the problem of marketing, discussions should be held about the establishment and expansion of subcontracting opportunities with small, medium, and large-scale enterprises.
- 5) Access to private sector organizations and formal or informal linkages or business cooperation amongst enterprises** – Discussions should be held about mechanisms to enable informal sector operators' participation in training programs trade fairs, meetings, etc of formal private sector organizations. Discussions should also be held regarding formal and informal linkages or business cooperation through networking. The development of the legal and institutional mechanisms to enforce contractual obligations and government policy to design appropriate incentive mechanism to encourage the expansion of business linkages/sub contracting managements should be discussed.
- 6) A clear and pragmatic national policy to enhance the development of the private sector and MSEs** – As most interventionist policies regarding MSEs are inappropriate and impractical, discussions should be held about the over regulation of government policies and how to reduce the bureaucracy and the unfriendly support to small businesses.
- 7) Entrepreneurial, managerial and other skills as well as skilled work force** – Discussions should be held about the general lack of knowledge entrepreneurial and managerial capacity and marketing experience. Lack of skilled labor, which in turn leads to problems in production due to the unfamiliarity of workers with rapid changing technology, lack of coordination of production process, and inability to troubleshoot failures on machinery and/or equipments is a critical problem.

- 8) Socio cultural constraints** – Another relevant area of discussion should be the lack of enterprise culture in the country, which required a drastic change; the considerable lack of positive attitude in the country as well as the excessive corruption, which actually constrains the development of private enterprise.
- 9) Coordination Among Business Development Service (BDS) Providers-** Discussions should be held about the co-ordination among the various actors in the provision of business development service providers in the country.
- 10) Easy entry and easy exit from the informal sector as opposed to realities of the formal sector** – Procedures to enter and especially procedures to exit should be discussed as they are cumbersome and discouraging for informal sector operators to become formal. There is a great need to build the capacity of ministries in service delivery.
- 11) Inadequate information about the procedures on becoming formal** – Discussions should be held about how to enhance the efficiency and effectiveness of public officials in kebeles and weredas in providing information and also about fighting corruption.
- 12) Overall mistrust between government, informal sector operators and private sector operators-** There is a general mistrust, fear and perception that the government is against entrepreneurs. Discussions should be held about good governance and encouragement of private sector initiatives by the government.

Generally, in order to make informal sector partners to the formal sector and to eventually help them graduate to the formal sector, policies and strategies should have to build confidence, help them in defining their needs, identify interrelationships between various forms of assistance (e.g. credit, training, technology, access to information, etc) and assess their capacity for absorption of assistance.

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