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Alleviating the Barriers to Domestic Investment in Addis Ababa: Underlying Causes and Proposed Solutions¹

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Abstract

While Addis Ababa is rapidly urbanizing, productive job creation remains to be a key challenge (i.e., unemployment rate stands at 21%). The root cause of this has been the lack of structural transformation towards industries with higher potential for growth and job creation. In response, the government of Ethiopia through its Growth and Transformation Plan (GTP2) targets the industrial sector to enhance structural transformation and create more

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productive jobs in Ethiopia's cities. Despite the priority and importance accorded to the industrial sector and efforts to improve the investment environment, quite a few domestic investors go beyond the licensing stage to start production. A recent World Bank report on the investment climate in Addis Ababa shows that only about 5% of domestic firms that receive investment licenses are able to convert from the pre-operational to the operational phase of investment to establish their businesses. This is also consistent with government reports. By any standard, this is one of the lowest investment conversion rates, and hence is quite concerning. So, the key question is: why 95% of investors were not able to move beyond the licensing stage to start operating? As we are largely looking at the pre-operation investment phase where there are no existing survey data, a qualitative research approach seems more fitting to identify the wide variety of processes and mechanisms that hinder business entry in the city. Using the qualitative/semi-structured firm level research among the firms who received an investment license but are stuck or discouraged allows us to ask questions on how and why specific processes are hindering investors and chart out the whole process investors go through, identifying the most critical barriers.

Key words: Ethiopia, Addis Ababa, Domestic investment, Conversion rate, Investment barrier, Qualitative research

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1. Introduction

The Government of Ethiopia (GoE) is committed to rapid and sustained economic development to realize the middle income goal by 2025. Ethiopia's remarkable economic performance in the past decade 2003/4 – 2014/15 (averaging about 10.9 percent per annum compared to 4.6% and 2.5% growth experienced by the Sub-Saharan Africa region and the global economy over the same period) shows that the country may be well-placed to achieve this target. The conditions for this are particularly set out in the Growth and Transformation Plans (GTPs) and various strategy documents complementing the GTPs. Through the GTPs, Ethiopia aims to build an economy whose growth is driven by modern and productive sectors, including a vibrant agricultural and a competitive industrial sectors. Especially GTP2 sets out an ambitious vision to become “a leader in light manufacturing in Africa and one of the leaders in overall manufacturing globally”. Over the next five years (GTP2), the aim will be not only to continue the growth momentum but also to achieve a significant structural transformation, in terms of value addition and employment creation in the modern sectors. At the heart of structural transformation are policies that are designed to generate maximum inter-sectoral linkages and domestic enterprise capacity building. Not surprisingly, the manufacturing sector is believed to generate high inter-sectoral linkages, value additions and skills and productive and stable employment that further reinforce each other to drive the whole economy into sustained growth. To this end, the government of Ethiopia (GoE) has already highlighted in its Growth and Transformation Plan (GTP) industrialization as a key to sustaining growth and as an impetus for economic structural transformation.

Despite the fast growth record in recent years, Ethiopia in general and Addis Ababa in particular faces lack of structural transformation and high urban unemployment rate. In terms of structural transformation, Addis Ababa fared little. The manufacturing sector employment stands at about 15 percent in 2015/2016 (WB 2016). With fast economic growth that is accompanied by rapid structural transformation, there is a huge potential for economic growth and job creation in the manufacturing sector to be had. Urbanization processes that are not accompanied by structural transformation tend to have limited capacity to expand and create productive jobs for the urban youth. In terms of unemployment reduction, unemployment has decreased from 33 percent in

2004 to 21 percent in 2015 (WB 2016). However, it is still high and remains to be a top priority in the city's development agenda.

Ethiopia has now started implementing GTP2, which sets even more ambitious targets for industry and manufacturing to grow at an average rate of 19.8% and 23.9% per annum respectively, leading to a rise in its GDP share to 23% (and manufacturing to 18.8%) by the end of the GTP2 period while that of agriculture and services decline to 36% and 41%, respectively. This industrial development vision and target hinges on attracting both domestic and FDI manufacturing firms. But especially Ethiopia's Industrial Development Strategy (IDS) puts the role of domestic investment or manufacturing sector in the industrial journey of Ethiopia as critical or irreplaceable. The reasons for this are:

- Domestic investment is reliable and sustainable. For local investors, Ethiopia is their country with which they have significant ties; hence, they continue to create more wealth and employment unlike foreign firms who tend to migrate whenever better opportunities arise elsewhere.
- The anticipated benefits of FDI (technology transfer, job creation and market linkage) can only be realized if we have a dynamic domestic private sector. There is no such thing as technology transfer and market linkage unless you build a vibrant and dynamic domestic private sector.

However, although the IDS emphasizes domestic investment as key to sustainable industrial development and the investment promotion strategy started to attract domestic investors to the manufacturing sector, quite a few of them go beyond the licensing stage to start production. Many domestic potential investors are either stuck or discouraged by the constraints and market failures they face along the investment process. To achieve the needed economic diversification and industrial led by robust domestic private sector, we need to understand why domestic firms get stuck or discouraged and fail to operationalize. In light of this, the key research questions this research work tries to address include:

- (1) The first question relates to business entry or conversion from license to operation. Studies indicate that only 5% (about 10% according to government reports) of domestic firms that receive investment licenses are able to convert from the pre-operational to the

operational phase of investment to establish their businesses. By any standard, this is one of the lowest investment conversion rates, and must be addressed head-on. On the other hand, conversion rates for foreign investors in Addis Ababa are high, even by international standards (at 60%). This indicates that domestic investors seem to face several possible market failures and constraints that could be affecting their ability to establish their business. And these problems seem to be particularly severe for domestic firms as can be seen from the low conversion rates. So, the key question we want to address is why 95% (90% according to government reports) of investors were not able to move beyond the licensing stage to start operating?

- (2) The second question relates to business expansion or growth. Even if some succeed and operationalize their business, they fail to expand or grow. So, in light of this, we want to know what particular obstacles and market failures are impeding the growth of domestic manufacturing enterprises in Addis Ababa once they are operational.
- (3) And what should be done to improve the low conversion rates and induce the development of a more dynamic domestic manufacturing sector?

Previous studies on similar issues relied on existing survey data sources which do not contain stuck/discouraged investors in their sample. For example, most World Bank Enterprise Surveys and the Ethiopian Central Statistical Agency's surveys of large and medium scale manufacturing firms relied on data from operational firms, which could not definitively answer the question of why 95% of investors were not able to move beyond the licensing stage to start operating. In view of this, we think that qualitative firm level research among the firms who received an investment license but are stuck/discouraged is likely to be very useful in finding out, from their experience, what were the factors that led to either their success or failure in operationalizing their investment idea.

The overall objective of this research is to inform the Addis Ababa city government on the key domestic investment barriers and market failures that are constraining business entry and growth. The report specifically aims

- a. To support the Addis Ababa City Government in understanding the key barriers to business entry in the city

- b. To produce practical policy and practice recommendations that can be acted upon by the Addis Ababa City Government, either within their own areas of jurisdiction or in partnership with other relevant stakeholders

The contributions of the current research comes from two aspects: (1) gathering more detailed information on the barriers to investment in order to understand why firms got stuck or discouraged in the investment process; and (2) making specific recommendations that are implementable by the Addis Ababa City Government based on existing stock of the quantitative and qualitative evidence available to date.

The rest of the paper proceeds as follows. While Section two provides background information, objectives and research questions, section three reviews key policies that are targeted at investment promotion and job creation. Section four presents our approaches and method of analysis. Sections five and six present the key findings of both the firm and key informant interviews. And finally, section seven synthesizes the key challenges and possible recommendations of the research work.

2. Project background and objectives

While African cities are rapidly urbanizing, and some have recently experienced robust economic growth, job creation in cities remains a challenge with high unemployment levels and the majority of people being employed in the informal sector. At the root cause of these problems has been the lack of structural transformation from low value added and non-tradable activities to other sectors and industries with higher potential for growth and job creation. In many African cities, rapid urbanization is taking place with little industrialization or structural transformation. Urbanization processes that are not accompanied by structural transformation tend to have limited capacity to expand and create productive jobs for the urban youth.

In addition, major supply constraints and market failures are likely to be hindering the competitiveness of local firms in African cities and their ability to expand and create jobs. To support African Governments in addressing this challenge, the World Bank recently developed a framework for enhancing the economic competitiveness of cities and designed this NLTA

entitled "Enhancing the Economic Performance of African Cities". The project is designed to provide insights to local policy makers on the city economy, what policies and investments could improve economic growth and job creation, and to support them in planning concrete interventions.

The World Bank included Addis Ababa as one of the four focus cities under this project to support the City Government in fulfilling its mandate for promoting economic development in the city and create jobs. The main client is the Addis Ababa City Government, where top government officials have shown commitment and interest to this agenda and has established a working group of staff from the relevant Bureaus within the City Administration to work on city competitiveness. Taking account of the city government's demand and strategic context in Addis Ababa in particular and Ethiopia in general, the project will concentrate on two main areas of support, where it can add most value: (i) city economic analyses, and (ii) institutional support and skills development.

This report focuses on one of the main outputs under the city economic analyses, which focuses on "qualitative research on key constraints for investment by domestic firms at the city level". The many consultations with the Mayor's office and other key stakeholders helped to understand and address their specific knowledge requests and gaps, which currently constrain domestic investment entry and growth. Hence, the key research question this report tries to answer is: how is the environment for business in Addis Ababa impacting investment conversion rates of domestic investors? The research question is motivated by the low conversion rate of domestic investment. This concerning finding was highlighted by the World Bank's recent report on the investment climate in Addis Ababa⁵. The report highlights the fact that only 5% of domestic firms that receive investment licenses are able to convert from the pre-operational to the operational phase of investment – to establish their businesses. This is also consistent with other studies where entry regulations and processes are consistently highlighted by the private sector as burdensome and obstructive to firm entry and dynamism - such as the EEPFCF National Business Agenda and the Doing Business Indicators, where Ethiopia ranks 168th out of 189 economies on the *Starting a Business* indicator. On the other hand, conversion rates for foreign

⁵ World Bank (2014). Investment Climate from the Perspective of Regions: Addis Ababa, Oromia and Dire Dawa. Addis Ababa, December 2014.

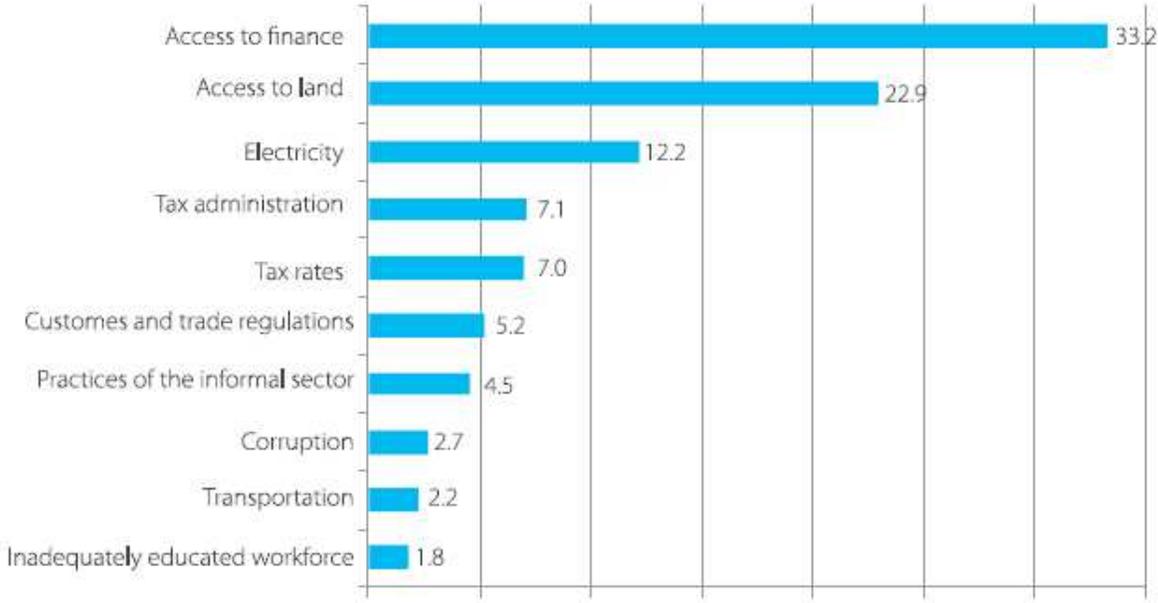
investors in Addis Ababa are high, even by international standards (at 60%). But in the case of domestic investors, the report highlights several possible market failures and constraints that could be affecting their ability to establish a business – such as the regulatory environment, access to finance, land, electricity, skilled labor, and others. However, as the reports relied on existing survey data sources which do not contain stuck and discouraged investors in their sample – namely the World Bank Enterprise Surveys and the Ethiopian Central Statistical Agency's surveys of large and medium scale manufacturing firms – it could not definitively answer the question of why 95% of investors were not able to move beyond the licensing stage to start operating.

Answering this question is of particular relevance to policymakers at the Addis Ababa City Government, given that facilitating domestic investment is within the direct remit of its Investment Office. The low investment conversion rates of domestic firms points to the existence of some obstacles that firms face between the point where they obtain a license (at the beginning of the process for establishing a business) and the point where they obtain a business registration (at the end of the process for establishing their business). It is, therefore, important for the City Government to know what measures it can take to improve the chances of domestic businesses establishing themselves in Addis Ababa, in order to expand economic growth and job creation in the city.

While abundant research evidence already exists in Ethiopia identifying the general categories of constraints affecting the performance of existing firms, there has been little focus on the ones that were stuck in the process or discouraged from entry due to the prevailing business environment. A number of high quality studies have been undertaken in the last few years on constraints to existing firms, including the Ethiopian Public Private Consultative Forum (EPPCF) National Business Agenda Report (2014); the World Bank's Doing Business (World Bank 2014) and Enterprise Survey (World Bank/IFC 2012) reports; the World Economic Forum's Global Competitiveness Report 2013-2014; and the various relevant studies undertaken by the Private Sector Development Hub³ and the results and recommendations of the Public-Private Consultative Fora held since 2010. For example, see Figures 1 and 2 below summarizing some of the most severe barriers mentioned by firms. In the former case, access to finance and land are the first two major obstacles. In the latter case, tax administration, access to finance and land (in

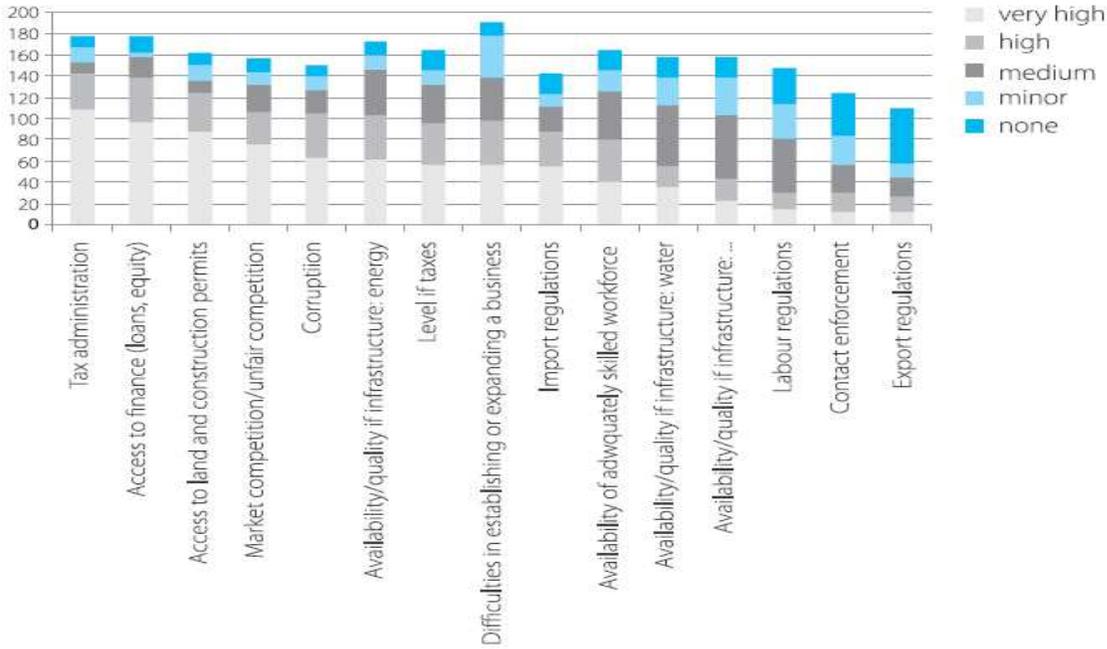
order) are the three severe obstacles in doing business. The studies have also informed public private dialogue efforts between representatives of the private sector and the highest levels of Ethiopian Government, and a number of policy reforms have been implemented as a result.

Figure 1: Top 10 business environment constraints in Ethiopia (2011/12)



Source: World Bank / IFC Enterprise Survey 2012

Figure 2: Severity of barriers of doing business summary



Source: Consultations for National Business Agenda in Ethiopia held by the World Bank

3. Addis Ababa’s (Ethiopia’s) targeted policies to enhance investment and create productive employment

3.1. Economic performance

i) Ethiopia: Economic Performance

Ethiopia’s vision is to achieve lower middle income status by 2025. Ethiopia has made significant progress towards this goal by registering an average growth rate of 10.9 percent over the last two decades, which in turn reduced poverty significantly (see table 1 and 2).

Period	Average Growth Rate (%)
1975/1976 – 1991/1992	1.7
1992/1993 – 2002/2003	5.5
2003/2004	-2.1
2004/2005 – 2014/2015	10.9

Table 2. Ethiopia's Poverty Levels

<i>Period</i>	<i>Poverty (%)</i>
1996/1997	45.5
2014/2015	25

Source: MoFEC

This remarkable growth has been made possible as a result of a strategic focus from top levels of government and through the systematic implementation of national growth strategies, from the Plan for Accelerated and Sustained Development to End Poverty (PASDEP, 2005-2010), and the subsequent two 5-year Growth and Transformation Plans (GTPI, 2010-2015 and GTP II, 2016-2020). While the PASDEP helped to experiment and better articulate policies and directions, GTPI with more clarity and ambitious goals laid the basic foundation for industrialization through massive investments in infrastructure and technical skills. However, although a remarkable growth achieved over the PASDEP and GTPI period, the structural shift in the economy was not on the scale and speed envisioned by the GTPI. By the end of the plan period in 2015, the industry sector contributes to 15.1% of total GDP with a 4.8% contribution from the manufacturing sector. However, this performance fell short of the 18.8% target set. As a result GTP II recognizes that the growth of the manufacturing industry which is fundamental for structural transformation clearly needs to be accelerated. GTP II especially stresses the development of a dynamic industrial sector, with especial focus on light manufacturing.

ii) Addis Ababa: Economic Performance

In the past two decades, the Addis Ababa city has witnessed one of the most remarkable growth performances. Over the GTP I period 2010-2015, Addis Ababa grew at an average economic growth rate of 14%. The fast and sustained economic growth created employment opportunities and increased income levels - i.e., per capita income has jumped from 788.47 USD in 2010 to 1,359 USD in 2015. The growth in income levels has in turn resulted in significant poverty reduction, where the poverty head count ratio declined from 38.7% to 29.6% in to 18.9% in 2015. Similarly, unemployment rates have decreased from 18.45% to 14.55% in the 2010 – 2015 period.

3.2. Targeted policies to enhance investment and create productive employment

In order to achieve these goals, Ethiopia has introduced several investment incentives and business friendly policies to attract domestic and foreign investments, which are consistently implemented in all regions, with some variations. For example, depending on the specific activity and the location of the investor, income tax exemption ranges from 1 to 8 years in Addis Ababa, while it ranges from 1 to 9 years outside Addis Ababa. Ethiopia's industrial policy is to attract FDI strategically and support the domestic manufacturers to form and maximize linkages. The latter is a key component of Ethiopia's industrial policy. This is because the dynamic benefits of FDI investment can only be realized if there is a vibrant domestic manufacturing sector to form positive linkages.

i) Regulatory and institutional support

Ethiopia drafted the Investment Proclamation in 2012, which was also revised in 2014 to reflect Ethiopia's enhanced commitment and institutional restructuring and the coming of industrial parks. The proclamation was established to guide Ethiopia's investment activities and defines major investment incentives and property guarantees. The Proclamation became quite necessary especially as the GTPs squarely stress industrial development through the FDI inflow and domestic private sector investment. According to Proclamation 769/2012, the rationales include:

- The encouragement and expansion of investment, especially in the manufacturing sector, has become necessary so as to strengthen the domestic production capacity and thereby accelerate the economic development of the country and improve the living standards of its peoples;
- It has become necessary to further increase the inflow of capital and speed up the transfer of technology into the country;
- It has become necessary to enhance and promote the equitable distribution of investments among regions and benefit the society by ensuring competitiveness among investments made by investors;
- It has become essential to put in place a system of supervision to ensure that permits and incentives granted to investors are used for the intended purposes;

- The system of administration of investment needs to be transparent and efficient;
- It has been considered that the establishment of industrial development zones helps, by creating enabling and competitive condition, to interrelate manufacturing sectors based on value creation as well as to attract and expand investment.

The Investment Proclamation also provides investment guarantee against measures of expropriation and nationalization that may only occur for public interest and in compliance with the requirement of the law. Where such expropriations are made, the Government provides adequate compensation corresponding to the prevailing market value of property and such payment is effected in advance. Ethiopia is a member of the World Bank-affiliated Multilateral Investment Guarantee Agency which issues guarantees against non-commercial risks to enterprises that invest in signatory countries. Ethiopia has also concluded bilateral investment promotion and protection agreements with a number of developed and developing countries.

In terms of institutional structure, the revised Investment Proclamation (849/2014) restructured the existing investment-related organizations. According to the revised Proclamation, the highest body in deciding investment policy is the Ethiopian Investment Board (EIB) chaired by the Prime Minister. The Ethiopian Investment Agency (EIA), which was under the Ministry of Industry was restructured as the Ethiopian Investment Commission (EIC) and is now directly under the Prime Minister's office. The Ethiopian Investment Commission (EIC) serves as the secretariat for EIB. The 2014 amendment also provides flexibility for the EIC to decide on appeals submitted to it by foreign and domestic investors on specific projects. In addition, the new EIC Investment Board is empowered to authorize the granting of new or additional incentives other than what is outlined under the existing regulations and authorize foreign investment in areas, otherwise exclusively reserved for domestic investors, if the exception is in the 'national interest.' The reason for establishing EIB and upgrading EIC in 2014 is that in the past the Council of Cabinet Ministers had to decide special incentives for priority projects on an ad hoc basis. But now the EIB can take over that function on a regular basis without the trouble of convening a Cabinet meeting. Moreover, the Ethiopian Industrial Development Zone Directorate under the MOI was strengthened and reorganized as the Industrial Park Development Corporation (IPDC) under the Prime Minister's Office. The EIC serves the regulatory body of the IPDC.

In addition to the above regulatory and institutional support, the Ethiopian Investment Commission is working towards achieving a one stop service for investors to shorten investment processing time. The industrial parks are also meant to shorten investment process as IPs provide access to factory sheds, infrastructure, basic services and skills, which enables them to set up their factories in a short time.

ii) Direct Policy Support

In addition to the overall economic liberalization, Ethiopia has introduced major investment incentives:

- (a) Import Customs Duty Exemption, where import of capital goods and construction materials is completely exempted from import duty
- (b) Customs Duty Drawbacks for those who import raw materials and packaging supplies for processing exportable goods – i.e., the exporter can claim the drawback on material used for the manufacture of export products
- (c) Voucher Scheme - deposit voucher with customs authorities and customs formalities can be carried out after raw materials (imported for producing exportable commodities) are kept in the private warehouse of the investor in the production site. This saves time on customs clearance and enables duty free import and use of raw materials.
- (d) Bonded Warehouse Facility - provides duty free privileges for raw materials used to produce exportable goods and allows customs clearance to be carried out at the warehouse of the investor. Customs official will be physically present when raw materials are removed from the warehouse for production
- (e) Income Tax Exemption - income derived from an approved investment is exempted from income tax ranging from 1 to 9 years depending on the area of investment, export volume and investment location. On the other hand, income tax exemption incentives for industrial park tenant manufacturing firms range from 8 - 10 years.
- (f) Carry Forward of Losses - investors are also allowed to forward losses incurred during the tax break period for half of the income tax exemption period
- (g) Straight Line Depreciation - investors are allowed to use straight line depreciation methods for their financial statement.

- (h) Cheap and Expedited Investment Land - availability of land that is owned by the state with very low lease price
- (i) Access to Subsidized Credit - availability of loans from the DBE with reasonable interest rate
- (j) Cheap utilities – electricity and water are quite low.

4. Approaches

As outlined above, the literature undertaken so far tend to focus on the firms that succeeded in establishing a business but, to our knowledge, none have focused on the firms that did not succeed or were stuck and discouraged by the environment for business in the city. To this end, we think that qualitative firm level research among the firms who received an investment license but are stuck or discouraged is likely to be very useful in finding out, from their experience, what were the factors that led to either their success or failure in operationalizing their investment idea. The added value of this approach is that it introduces two new aspects that are particularly relevant to the Addis Ababa City Government, where knowledge gaps exist: (1) business entry obstacles and constraints, and (2) stuck and discouraged investors as a sampling frame.

4.1. Semi-Structured interviews with firms and key informants

We developed semi-structured questionnaires both for firms and key informants. The firm questionnaire seeks to gather information on various issues including profiles, general information, market and demand conditions, labour, tax, customs practices, regulatory, finance and foreign exchange issues, infrastructure and public services including security and property protection, macroeconomic issues and rent-seeking behavior. Since problems/issues/gaps may vary depending on the status of the investment (pre-implementation, implementation and operation phases), we asked questions for each phase. Furthermore, to ensure that we have captured the latest developments in Addis Ababa and to make sure our questions elicit the most information needed to analyze, we started with an inception phase which includes testing the questionnaire and talking to relevant institutions and people before we administered the survey.

4.2. Sampling strategy for semi-structured interview

Our sampling frame (or the complete list of domestic investors) came from the Ethiopian Investment Commission (EIC). Using a non-probability sampling method, we then drew our samples from the list in such a way that the sampled investors are recent so as to reflect existing investment environment and those that have been stuck for long enough who have enough stories to tell why they have been stuck or discouraged by the investment environment. In the selection of firms, therefore, we used both purposive and quota sampling techniques. The rationale for using purposive sampling was to find investment owners with enough experience and stories to directly answer the research question. Furthermore, in line with the research objective, only domestic investors who applied for investment and are stuck or discouraged were interviewed to understand and identify the constraints faced by investors who have failed to convert their proposal into actual investment. Our sample also includes investors from all major sectors – manufacturing, service and construction. In other words, although our sampling strategy is non-probability and purposive for the reasons stated above, we tried to stratify it by sector and their investment status as problems/constraints may vary by sector and investment status. So, considering all the above criteria and qualifications, a total of 42 firms were selected and interviewed using a semi-structured questionnaire (see table 3).

Our sample included not only firms, but it also includes key informants. This helps to triangulate and verify the information mentioned by firms on the regulatory obstacles. Similarly, the key informants were selected purposively according to their involvement in the investment processes. These included government institutions (e.g., Ethiopian Investment Commission, Addis Ababa Investment Agency, Addis Ababa Bureau of Industrial development, Mayor's office), financial institutions (e.g., Development bank of Ethiopia and the national Bank of Ethiopia) and Addis Ababa Chamber of Commerce representing the business community.

Table 3: Sample - List of firms interviewed during the semi-structured interview

S/N	Sector	Specific Sector	Year of Registration	Status of Investment	Status of Investment
1.	Construction	General contractor and Machinery rental	2013	Discouraged/Cancelled	Discouraged
2.	Manufacturing	Mechanical Engineering Workshop	2014	In process – pre-operation stage	Stuck
3.	Manufacturing	Plastic material production	2014	In process – pre-operation stage	Stuck
4.	Manufacturing	Edible Oil Production	2014	Operational	Successful
5.	Manufacturing	Plastic Materials and Packaging	2014	Discouraged but operating in his residence in a limited manner	
6.	Construction	General contractor	2014	Operational	Successful
7.	Service	Specialized Hospital	2013	In process – pre-operation stage	Stuck
8.	Manufacturing	Mobile Battery and Power Bank Production	2011	Discouraged but operating in his residence in a limited manner	
9.	Manufacturing	Metal Workshop and Car Body	2012	In process – pre-operation stage	Stuck
10.	Manufacturing	Furniture Manufacturing	2013	Discouraged/Cancelled	Discouraged
11.	Manufacturing	General Metals and car body	2013	Discouraged/Cancelled	Discouraged
12.	Manufacturing	Drug Company	2014	In process – pre-operation stage	Stuck
13.	Service	Three start Hotel	2013	Discouraged/Cancelled	Discouraged
14.	Manufacturing	Building Materials Production	2015	In process – pre-operation stage	Stuck
15.	Service	Liquid and solid wastage disposal service	2014	Operational	Successful
16.	Service	Printing enterprise	2014	In process – pre-operation stage	Stuck
17.	Manufacturing	Coffee processing	2014	In process – pre-operation stage	Stuck
18.	Manufacturing	Printing industry	2013	In process – pre-operation stage	Stuck
19.	Manufacturing	Producing metal framework	2014	In process – pre-operation stage	Stuck
20.	Manufacturing	Paper package production	2014	In process – pre-operation stage	Stuck
21.	Service	Hotel and restaurant	2014	In process – pre-operation stage	Stuck
22.	Construction	Building contractor)	2010	Discouraged/Cancelled	Discouraged
23.	Construction	Building contractor 6	2012	In process – pre-operation stage	Stuck
24.	Manufacturing	Construction chemicals production	2010	Operational	Successful
25.	Manufacturing:	Mgmt. of electric equipment	2012	In process – pre-operation stage	Stuck
26.	Manufacturing:	Production of machinery	2014	In process – pre-operation stage	Stuck

27.	Service:	Tour and travel service	2015	Discouraged/Cancelled	Discouraged
28.	Manufacturing	Local Drinks	2014	In process – pre-operation stage	Stuck
29.	Manufacturing	Ginning and spinning of fiber	2011	Operational	Successful
30.	Manufacturing	Medical Equipment	2005	Operational	Successful
31.	Manufacturing	Poultry and Wood Floor	2011	Operational	Successful
32.	Manufacturing	Car Assembly	2014	In process – pre-operation stage	Stuck
33.	Manufacturing	Machinery Spare Parts manufacturing	2012	Discouraged/Cancelled	Discouraged
34.	Service	Hotel and Restaurant	2012	In process – pre-operation stage	Stuck
35.	Manufacturing	Chemical/Cosmetics	2004	In process – pre-operation stage	Stuck
36.	Construction	Machinery Rental	2004	Operational	Successful
37.	Manufacturing	Wood and Metals Workshop	2015	Discouraged/Cancelled	Discouraged
38.	Construction	Machinery Rental	2013	Discouraged/Cancelled	Discouraged
39.	Manufacturing	Marble cutting	2013	Operational	Successful
40.	Manufacturing	Garment	2014	In process – pre-operation stage	Stuck
41.	Manufacturing	Food processing	2014	In process – pre-operation stage	Stuck
42.	Manufacturing	Ceramics	2014	In process – pre-operation stage	Stuck

4.3. Data collection techniques

We conducted in-depth semi-structured interviews with investment owners to gain deep insights into a multitude of the processes and mechanisms that hinder business entry in Addis Ababa. Accordingly, respondents were asked to narrate their experiences of the processes and challenges they encountered from the point where they applied for investment license to their current status (or the operation stage if they succeeded in operationalizing their business). So, our data is collected based on qualitative semi-structured interviews with firms and key informants. We conducted in-depth interviews with the selected samples. The average interview time was about 1 hour 20 minutes. Since the questions were semi-structured, it provided firms to flexibly express their opinions and experiences of the investment processes and obstacles and the likely reasons for their successes or failures to convert their business proposal into operations. We also conducted key informant interviews to further understand the obstacles and to verify the information we obtained from investors.

4.4. Analysis Method

We used the method of thematic analysis in describing and interpreting the qualitative data we collected through firm interviews. Basically, the analysis proceeds as follows:

- (i) Transcription – first, transcripts are typed, edited and labeled. This eases the analysis process.
- (ii) The next step is reviewing the transcripts to understand the information collected. This gives us a sense of the bigger picture before moving into the details. This stage helps the formulation of the thematic areas that have emerged from the data.
- (iii) The third step is then developing thematic areas. The paper is organized based on the emerging themes from the data. The process of developing emerging thematic areas entails grouping or categorization of data of the same or related meaning.
- (iv) In the final step, we undertake a deeper analysis of patterns and the thematic areas that have emerged. Emphasis to an issue has been given not only based on how frequently it emerged but also on the energy and enthusiasm it generated during the discussions. We

also investigate deviant cases and provide explanations in an attempt to draw strong and weak patterns.

5. What constrains domestic investment in the Pre-Operation Stage in Addis Ababa?

This section details the key constraints domestic investors face in the pre-operation stage. In the Ethiopian investment registration system, an investor passes through the pre-implementation, implementation and operation phases. In the pre-implementation stage, the investor processes and authenticates his/her documents in the EIC and applies for land and duty free privileges. In the implementation stage, the investor acquires land, conducts environmental impact assessment and constructs the factory and accesses basic services and infrastructure such as electricity, water, and telecom services, etc. In the operation stage, the investor starts actual production (see figure 3).

Figure 3: Stages of Business Entry in Ethiopia: Pre-implementation to Operation

Pre-implementation to Implementation “Investment Phase”	Implementation to Operations “Operational Phase”
Authentication of company’s documents by EIC	Acquisition and allotment of land
Tax registration (Tax Identification Number and VAT certificate)	Environ. Impact Ass study and EPA/REPA authorization
Commercial registration, including clearance of trade name	Construction permit to start construction on land
Open a bank account and minimum capital deposit	Access to water, electricity and telecom services
Lease land application + down payment for acquisition and land title deed	Expatriates work permit
Certificate of capital importation	Certificate of competency
Investment Permit	Renewal (annually) of investment permit and updated status report (every 3 months) until operations start.
Residence Permit	Business license

Source: Ethiopia Investment Commission (as documented in the World Bank (2014) Investment Climate Study on Addis Ababa). The steps highlighted in Blue and Bold are highlighted as the most cumbersome for firms.

The objective of this section is not to come up with a laundry list of the constraints domestic investors face in their process to start and expand their business nor to rank the constraints. But to give a detailed analysis of the key constraints and market failures and how they affect business entry, expansion and growth. The findings are drawn from the field surveys (both firm and key informant interviews). We also supplemented the findings by reviewing the literature and other

secondary sources. So, based on the semi-structured interview with firms and key informant interviews and review of literature, the following key constraints emerged as quite crucial in terms of affecting the investment conversion rate and the overall business environment in Addis Ababa city.

5.1. Bureaucratic inefficiency

The inefficiency in the bureaucracy is expressed in various ways. The first problem under this is the lack of clear and complete information about investment processes, institutions and the order in which these processes must be undertaken. There are a number of processes investors must go through from the point of registration to the point of operation. Since the one stop service center is not fully operational, investors are required to go to various government institutions that are scattered around the city to process their investment registration and application. And each institution requires a number of documents and formalities. While the fact that the institutions are scattered is a problem by itself, what is even more problematic is that most institutions don't provide clear and complete information on what documents are required and the order or sequence of the processes in which they must be undertaken. Due to the lack of complete information on what the processes and requirements are, investors tend to spend significant amount of their time unproductively searching and gathering information to obtain complete information on the investment processes, required documents and institutions and the order of the processes/institutions.

The second prevalent problem is the lack of timely decision on the part of bureaucrats or civil servants or higher officials. Frontline officers suffer from indecision or inaction for fear of committing mistakes which might turn against them in the form of abuse or corruption. And abuse or corruption is followed by severe punishment although detection is quite low. As a result frontline or even middle level officials shy away from making key and timely decisions, which results in the accumulation of pending issues and making investors to make frequent travels to ask if their issues have been resolved. In other words, frontline and middle level officials and civil servants know that while making decision mistakes (especially issues regarding land, credit and tax) might be met with severe punishment; indecision and/or inaction are not punishable. The indecision problem is especially prevalent when rules, regulations and guides are unclear

and decisions involve significant resources such as land, finance and machineries and taxes. Most investment issues/cases are of this nature. Moreover, investment demands/requests are quite differentiated and hence require a case-by-case treatment, which in turn requires officials to make tailored-decisions. Consequently, the equilibrium tends to be indecision and/or inaction by frontline civil servants and officials. Instead of acting and solving problems at the lower level, they simply accumulate them and pass them to higher officials, who are usually tied up with other meetings and political works, and are of course less aware about specific operations. This bureaucratic inefficiency takes quite a long time and costs investors time and money.

Third, government institutions use less of better technologies and methods that could speed up the investment processes. Most public institutions rely on paper works and traditional filing system. Digitizing the whole process would significantly cut the long process by reducing the search time and the tedious paper work. Or even smaller or incremental changes such as 5S would significantly improve the efficiency of the work place by making it tidy and better organized, where people can easily locate files and folders⁶.

Capacity of the civil servants is another one. The government sector seems to be trapped in low-skill equilibrium largely due to the low salaries and incentives. The main role of the government is to facilitate and unlock problems so that development happens in fast manner. It should not be considered as a job creation machine – it unlocks the private sector and other development actors to play an active role, where employment can be maximized. Interviewers explained the unresponsiveness of the public services in the form of:

Delay in appointments and frequent meetings have already become the culture for many of Addis Ababa city administration's public offices. In addition to this, corruption has become the normal way of executing services in government offices.

⁶ 5S is a workplace organization tool. It is a series of activities for eliminating unnecessary time and waste that contribute to inefficiency (e.g., errors, defects, etc). 5S is simple but powerful and pays off immediately. Upon implementing 5S, institutions can have organized and efficient workplace. 5S stands for five Japanese words, which are seiri, seiton, seiso, seiketsu and shitsuke. In English, they can be equivalently described as sorting, setting in order, sweeping, standardizing and sustaining.

5.2. Access to land

Land is a key resource. The role of land in development is three-fold. First, land is heavily used to support public finance. Land revenues constitute a large part of local revenues. The second role of land is land-based financing of urban expansion. Financing infrastructure through land leasing and bank loans securitized on land and property valuation accounts for a large percentage of infrastructure financing. This includes land financing directly (public land leasing) and indirectly (land used as collateral). The third role of land in development is associated with land based developments and reforms. Given the skyrocketed land prices, land is used to attract investments by providing free or subsidized land access. On the contrary, if unchecked, land is also open to speculation and bubble, where unproductive and non-value adding activities could take place.

With this background let's come back to the problem of land in the Addis Ababa city. The problem of access to affordable land in Addis Ababa emanates from two interrelated problems: limited availability of land and the lack of capacity to provide serviced land (land that is equipped with utilities, access roads and transport links to markets). Access to affordable land is quite important for investment entry. If investors are to acquire land on their own from private sources (through purchasing or renting a working space), then their limited capital which would have been allocated to productive investment or used as working capital to expand their business would simply be eaten up unproductively since acquiring land through private means is too expensive. Since industrial investments usually require a large tract of land, acquiring it through purchasing or renting from private sources is simply implausible. If a potential investor attempts to do that, he would simply reallocate his investment funds (i.e., fund which would have been used as start up or working capital) to buying land and this leaves him with no money to make new investment or expand existing investments. In other words, this is simply going to be speculative investment, which is usually classified as unproductive for there is no real production or value addition. And this retards economic growth, which in turn impedes job creation.

So, what is the alternative for potential investors to acquire land affordably? A relatively better but still expensive alternative is to acquire land through lease-hold. The city government announces pockets/pieces of land for lease regularly around the city, where investors can freely

bid. However, although somewhat better than acquiring land through private means, lease-hold is still quite expensive for potential investors. Consequently, most potential investors don't consider this option as viable because it would simply eat up their investment money and leaves them without finance to set up their factory. A cheaper alternative is to acquire land through public means – i.e., public allotment. The city government provides land to eligible industrial investors at very subsidized rates or even for free. Since this is the best alternative to acquire land, almost everyone opts for this option. However, the city administration has quite limited industrial investment land that it can allocate compared to the land demand (or requests). As demand far exceeds supply, land requests tend to accumulate in the city and the process of screening takes time and becomes tedious. For example, during our interviews we found out that there are up to 6000 potential investors in Addis Ababa who have placed their request for land and awaiting decision by the city administration. One of our respondents expressed the long delay as follows:

After I completed the pre-implementation processes, I transited to the implementation stage and applied for land. It has been almost two years since I applied for land. This is the major reason why I am still stuck. I didn't get land certificate yet.

The process of acquiring public land is quite slow for at least two reasons

- (i) Servicing land takes time and requires financial capacity – the city government has to first service the land before it allocates to eligible investors. Servicing land includes access to basic services such power, utilities, roads, transport links, and paying compensation, etc. The city administration has only limited capital budget that it can allocate for this purpose. Furthermore, provision of the basic services and infrastructure takes time.
- (ii) The land administration and management apparatus is far from modernization and professionalism. It lacks modern land administration and management institutions and professional such as cadastral systems, land use control mechanisms, and land market regulations.
- (iii) Demand for land exceeds supply of land. For this reason, the city government has to screen and prioritize out of the many land applicants. This screening and prioritization process is handled by committees that have been set up for this purpose. According to

the city administration, the rationale for establishing the committees is that land issues are prone to corruption. So, the fact that a committee consists of a group of people (usually above 4) is assumed to create some kind of check and balance to reduce corruption (i.e., nepotism, abuse, bribes, etc). The committees assess and screen land applications and provide information and assessment result to the city Cabinet, which makes the final decision whether a potential investor gets an land. Although the intention of the idea of group decision is good, the downside is that group decision tends to be inefficient in terms of providing timely decisions. The committee recommends list of applicants and passes them on to the Mayor and his cabinet for final approval. So the final decision rests in the Cabinet of the City Government.

While the first problem is relatively short-term problem which can be eased over time when the city's implementation and financial capacity improves, the second problem is more structural. The scope for Addis Ababa to expand in land mass is quite limited. It may also negotiate with the Oromia region on the appropriate compensation schemes to secure some land. However, land expansion is likely to exhaust. Hence, the supply shortage issue is more chronic and structural. The city government needs to look for a more sustainable option to solve the problem and improve the land use efficiency. Experiences of similar metropolitan cities can be quite instructive on how the city's economic structure and policy need to respond to the changing realities, especially in the face of scarce land.

5.3. Infrastructure

Ethiopia has been investing massively to improve its provision of basic services such as power, water and telecom services and key infrastructures to push the industrialization agenda. However, given the size of the country and the demand for these infrastructures, Ethiopia has still a long way to go. According investors, at the moment the key binding constraints from the infrastructure side is electricity. Powering Ethiopia's industrial development remains a key challenge, which is also precisely true in the capital of the country – Addis Ababa. The problem of power comes in three forms: lack of access, shortage and repeated power interruption.

The first problem relates to access. Since there is only one provider and there is a long queue to get connected to the national grid, getting connected to the national grid remains a challenge. One has to wait from 6 months to 1.5 years to get electricity access. This is largely due to the provider's institutional inefficiencies, where corruption and rent-seeking are rampant. New entrants that hope to get their factories running are forced to wait for more than a year to start production. Shortage is a problem by itself but the lack of access is not entirely explained by shortage. It is explained more by institutional inefficiency, lack of competition and corruption at the service provider. One of the participant interviewees expressed the following:

Accessing power is the major investment challenge. Power authorities commonly say that there is power shortage but I don't think it is the right reason. It seems that there is corruption in distributing power. After repetitive visits to the sub city EEPCO office, I am able to get power. However, it is difficult to say that the power is reliable now; to compensate power outage; I am using a generator. When we see the price per service, it is reasonable. Also, I have applied to get power for another investment and it has been three years since I started applying and waiting for electricity.

Another respondent reflected similar experience as follows:

When I applied for power access at the Ethiopian Electric Power Corporation, the officer I talked to asked me to transfer a big sum of money so that I can get transformer installed in a very short period of time. I refused to give and accused him. But then there was no response by the authorities and finally, I paid some 4700 birr after 11 months of wasting time due to redundant visit to the office and got power service for my business.

On the other hand, power shortage and repeated interruptions are also rampant but they affect more those firms that are already operational. These problems force firms to operate in shifts and to underutilize their capacity. The shortages and interruptions lead to intermittent production and sometimes machine breakages. It also exposes firms to higher production costs as most firms would want to use generators to complement the short and interrupting power that is coming from the national grid. This would have implications on the cost of their production and hence on their competitiveness as generators are much costlier than accessing power from the public utility company.

Another more salient problem when it comes to electric power is that if investors want to upgrade their electricity power access to industrial level access as a result of their business expansion or as result of setting up their factory near residential areas, investors emphasize the waiting time to upgrade their current access to industrial level is quite long. And even then investors need to bribe officials and technicians at the service provider. According to the interviews, it has almost become established that institutional inefficiency and corruption characterize the power provider, which aspiring investors find it quite frustrating to set up their factory and run operation quickly.

5.4. Finance

In relation to finance, the issues of finance range from access to finance in domestic market to access to foreign currency. Firms can secure finance for fixed investment and working capital for their projects through either own savings, traditional financial institutions and modern financial institutions. Own savings can take the form of profit/retained earnings from pervious business or personal savings. The second method is to use traditional financial institutions such as Iqub. The third option is approaching modern financial institutions for loan. In order to access foreign currency, the formal option is through banks. However, the informal foreign exchange market thrives because of the limited access in the formal market.

This section mainly deals with the challenges of access to finance from the modern financial institutions and it does not deal with the traditional and informal market as a source of finance. The financial institutions include commercial banks owned by the government or the private sectors, the Development Bank of Ethiopia, and microfinance institutions.

Close to twenty commercial banks are operating in Addis, in addition, there are also microfinance institutions. The commercial banks mostly cater to the demands of established businesses. These businesses usually have previous interaction with the bank and have fewer problems providing collateral for the requested fund. It is also usually not for long terms loans that can be used for investment financing as can be understood from the financial products advertised by the commercial banks.

In order to have a framework for the problem, this section aims to address the questions listed below. The issues will be examined rigorously to tease out recommendations to address the constraints faced by domestic investors in Ethiopia and Addis Ababa in particular.

- What types of financial services are severely constrained? (e.g., Finance for investment vs finance for working capital, long term versus short term loans, Foreign versus domestic currency etc.)
- Who has more problem accessing finance? The challenges for accessing finance could be heterogeneous across business.
- Which institutions are providing financial services and what are the challenges faced in indifferent institutions?

For manufacturing investments, financial sources from private sources (including private and commercial banks) are quite limited. Private financial institutions (commercial banks and microfinance institutions) focus on short-term loans, mainly for the trading sector. Long-term financing from private financial institutions is not only extremely limited but it is also extremely expensive. They charge prohibitively high interest rates and require significant collaterals.

So the cheaper alternative is to access finance from public sources, especially the Development Bank of Ethiopia (DBE). But the DBE has limited financial resources and thus prioritizes sectors. DBE is a policy lending institution, its lending criteria is in line with Ethiopia's industrial priorities, where the manufacturing, Agro-processing, large commercial farming and mining are the policy priorities. So an investor must be big enough and a priority sector to access DBE finance. Moreover, an investor has to provide equity of 25 percent to access the 75 percent from DBE. Since DBE's financing is project-based, no collateral is required and decision is based on cash flow of the project and feasibility of the project. Project loans are long term loans with a payback period of 5 to 15 years. The grace period can range from 1 to 5 years depending on the project. The loans can be used for construction, capital goods, and working capital. The interest rate ranges from 9 to 12 percent. Those exporting can enjoy 9% interest (if they export 80% of their product); 9.5% interest for import substitution; for others the interest rate is 12 percent. Since DBE does not require collaterals, it monitors and provides technical support to solve problems with the implementation.

For small businesses, DBE has just launched a new lease financing program. Once small businesses have the minimum capital, the DBE imports machinery and lease the machinery. For one enterprise up to 30 million birr is the maximum machinery cost allowed. The leasing period can go from 5 up to 10 years. The minimum requirements to get the lease financing are:

- Having 20% of machinery cost in blocked account (The 20% will be released for working capital)
- Employing at least six people

DBE's project finance has three phases. In the first phase, the DBE checks the customer's documents and appraises the customer in terms of risk, equity sources, business experience and credit history. If an applicant qualifies in the first phase, the second phase process begins. In the second phase, his project proposal is appraised. Appraisal of the project involves assessing the viability of the project. This includes appraising the loan amount and repayment schedule etc. DBE experts make recommendation/comments on the project appraisal. If the quality fulfills minimum standard DBE considers it. The last phase involves passing the final decision by the loan approval team. There are two independent teams at the head office: one approves 25 million to 150 million and the second one above 150 million. Branch offices can approve up to 25 million loan amount. And the decision is communicated back to the customer. DBE argues that if everything is done according to guidelines and regulations, the whole process takes about two months on average excluding waiting time for document for the customers. However, in practices it takes much longer – sometimes up to a year.

However, for many domestic investors, meeting the two key requirements is a challenge: a) raising the minimum equity 25 percent (a minimum of 7.5 million) is challenging. Although the 75 percent DBE loan is quite attractive, the 25 percent is too big for many domestic investors. Securing serviced industrial land or a 5-year contractual agreement of work premise is another challenge.

I started the business with my own savings. I had a plan to expand it through bank loan. But now I am frustrated with that plan. The overall environment is frustrating. I hear that 25/85 scheme is available for manufacturing business.

But I am afraid that the 25 percent capital requirement would be too big for me to raise.

Project finance/investment finance suffers the most in terms access to finance. Discussion with would-be investors has shown that securing loans for your investment for newly established businesses is one of the main problems that cause business to stall. This is because new businesses have limited interaction with commercial banks and most of the time have limited or no collateral. Second lack of access to land also limits ability of business to borrow from the formal financial institutions.

The interest rate is very high in the commercial banks. I didn't ask for loan from Development Banks either because banks ask for land collateral as collateral. I have had other properties such as cars and other fixed assets they don't accept them as collaterals.

Access to working premises as a constraint for accessing to finance

The main project financier, the Development Bank of Ethiopia, is said to favor foreign firms and large scale projects according to respondents. The problem of access to land faced by domestic investors also complicates the ability of firms to access loans from DBE. This is corroborated with our key-informant interview with DBE as one of the requirements is at least an agreement with the landlord for the period of the project to qualify for the loan. Hence, addressing the problem of sustainable working premises goes some way in solving the problem of access to project financing. This issue will also be faced by those who will seek finance from the commercial banks without land.

Financing requirement and Bureaucracy

DBE has a requirement as stated above that 25% contribution to the project cost in blocked account as a requirement. Investors feel that the deposit requirement in blocked account is excessive. The same issue has been highlighted as problem by DBE. The Bank believes the inability to raise the necessary capital to meet the 25% contribution and the fact that the money is kept in blocked account is an issue with investors. But DBE feels that it has to protect itself for the possible risk. Investors describe the bank as too bureaucratic and the practice is different from the policy while the bank argue that it cannot avoid being bureaucratic for the simple

reason that there is no collateral. Commercial banks collateral requirement has been raised as one of the barriers that prevent startups for getting access to finance from the commercial banks.

We also find that focus from the government side has been on small and micro enterprises and the commercial banks and DBE focus on established businesses and mega projects respectively. This might lead to unserved medium enterprises, leading to the problem of missing middle financing. As solution, DBE has a project in the pipe line which it refers as lease financing. The program targets medium level enterprises and plans to provide 80% of the project cost in terms of machinery. It is impossible to get the view of investor on the lease financing scheme as it has just started. We are informed that 8 billion birr is planned to be allocated to medium level enterprise through the lease financing scheme.

According to the interviews, domestic investors strongly believe they are being discriminated against FDI firms. Some of them even go to the extent of questioning why FDI firms should be financed by the DBE while they should come with their own finance. Other key informants such as associations and the chamber of commerce also have similar views. They believe that credit evaluation at the DBE is not fair and transparent.

5.5. Entrepreneurial Skills

Even firms that operate in the same business environment vary in terms of their ability to solve entry and growth constraints. In other words, while some firms find it relatively easy to enter and expand their business, other find it relatively difficult to enter and grow their business. Many studies have indicated that such persistent variations are largely attributed to entrepreneurial traits, competencies of entrepreneurs, and motivation level of entrepreneurs (e.g., see Baum et al., 2001; Hankinson et al., 1997; Hussin, 1997; McClelland, 1961; Olson and Bosserman, 1984). Prior to business entry and set up, prospect investors need to make thorough preparations in terms of business planning, market study and product development. There is a growing body of literature on the fact that entrepreneurial skills can be taught and hence are highly interrelated with factors such as the level of education, skill and international exposure. In terms of education and skill, highly educated and skilled managers tend to figure out easy entry points and make significant managerial innovations while less educated and skilled managers make only marginal

managerial improvement (e.g., see Ichniowski et al., 1995; Bloom et al., 2010a). Similarly, in terms of international exposure, those that are exposed tend to be innovative and better-managed than those that are not exposed firms.

From the firm interviews we conducted, we draw two important observations. The first observation relates to the preparation of business plans and market strategies. We found that firms do not make thorough preparation in terms of the preparation of business plans and marketing strategies before they enter into operation. For application purposes (because they are required to submit), they copy a standard business plan and make small changes and submit. However, it is well established in the literature that business plans and market strategies are key ingredients to success. An entrepreneur is supposed to have a clear vision and idea of the business operation and marketing strategies. We heard the same story from the DBE that firms invest quite less in preparing their business plans, which leads to the rejection of their application for credit. Expanding the overall education and TVET training systems definitely help in the long run but tailored managerial and entrepreneurship training on key managerial and entrepreneurial skills such as business planning, market strategies, book keeping, and so on are considered as direct solutions to the constraints emanating from entrepreneurial skills. Asked about what kinds of trainings would be important during the entry stage, they identified trainings on entrepreneurship, marketing, management, customer handling, Custom's process, taxation rules would be quite crucial.

The second observation relates to feasibility studies. While feasibility study is quite important aspect of the pre-operation process, it is relatively costly for prospective investors. They are considered as sunk costs. This is one typical market failure area that needs intervention. The idea that the state must assume larger part of the cost of feasibility studies is getting traction these days.

6. What Constrains Business Expansion and Growth After Domestic Firms Started Operation?

While section 5 analyzes the key constraints and market failures that are prevalent in the pre-operation stage, this section analyzes the key constraints and market failures that are hindering

business expansion and growth after firms started operation. The analysis in this section is based on interviews with firms that have moved to operation stage and the key informant interviews.

6.1. Land or working premise

Firms usually start small or at least with a reasonable size. With time, they learn better about production and marketing techniques, their competitors, and the technology. As their knowledge, confidence and profitability grows, they would like to expand further. In such endeavor, one of the key constraints would be securing additional land or working space. In many ways, the issue of land for expansion is even worse. It is true that Ethiopia's and Addis Ababa's industrial development should encourage both new entries and expansion of existing businesses. But according to the result of our interviews with firms, securing additional land is as difficult (if not worse) as getting new land. The city administration is simply unable to entertain most of the requests for land expansion due to limited land supply and other inefficiencies. This of course limits business growth and operation at full capacity.

So, since the demand for land expansion is usually unmet by the city administration through allotment or allocation, firms tend to relocate partially or fully within Addis Ababa where they can increase the size of their land through private purchase. Although acquiring land through private means is quite expensive, it makes sense for those firms that are operating to purchase land to increase or expand their existing factory. But sometimes, the relocation may be out of Addis Ababa to relatively land abundant areas such the Oromia region.

We think that relocation might be inevitable as the city government won't be able to satisfy the huge demand for expansion land. But Addis Ababa can retain its factories and businesses if they can utilize its existing land more efficiently. We think that avoiding sources of inefficiencies and promoting the industrial park development program should provide solutions for these relocating firms. These issues are discussed more fully in section seven.

6.2. Infrastructure/basic services

The key challenges under this are:

(i) Access roads

The major problems under this investors came up with are: confusion on cost/responsibility sharing, unresponsiveness of service providers and poor quality of roads. First, there is confusion when it comes to access roads – i.e., roads that connect a factory site to a main road. There seems to be confusion in responsibility as to who should bear the cost and if both must bear the cost, what is the percentage of each. Investors usually take the responsibility of building their access roads as the city administration (more precisely the Addis Ababa roads authority) appears to be unresponsive and waiting for them to respond would take time.

The second problem relates to shortage of roads in the city leading to major traffic jams and delays, which affects workers mobility from work to home and vice versa. The quality problem is also there, where many roads lose quality soon after they become operational and maintenance does not happen quite often. The quality problem has also something to do with the institutional inefficiency and rampant corruption we discussed elsewhere. According respondents, Akaki (which is an industrial area) specifically suffers from lack of roads and the ones that are functioning in the area need serious maintenance.

(ii) Power interruptions

According to our interviews with firms, especially investors that are engaged in the manufacturing sector feel the most the persistent power outage, coupled with the inability of the national electricity supplier to meet the ever growing demand. The power interruptions are detrimentally affecting their operations by inducing a fall in output and an upsurge in wastage. Firms use backup plans such as private generators to maintain production levels, but the extra cost they incur has led to a spike in production costs and thereby rendered them uncompetitive.

(iii) Upgrading to higher level industrial access

This involves the purchase of a transformer and upgrading to industrial level power access. When firms expand their business, they will have to upgrade their power access to meet

additional demand. However, we found out in the interview that this is not easy either. Like access, upgrade is also difficult owing to inefficiencies and corrupt practices. Although there is overall power shortage, which is structural and will get eased as Ethiopia produces more power from the ongoing hydro power projects; inefficiencies and corrupt practices play a significant role in distributing efficiently what already exists.

6.3. Finance and Foreign Currency

(i) Credit

Credit is a binding constraint not only in the pre-operation phase but also in the operation stage. For operating firms, the financial challenges are to operate their business smoothly (i.e., working capital) and to expand their business further (investment expansion capital). So, the lack of investment and working capital remain as key challenges for operating businesses.

Financial products from the private sector (commercial banks, etc) are characterized by

- a) Short-term loan, usually favoring service and retail sectors that require a relatively short maturity loans. They rarely finance long-term projects in the manufacturing sector. According to both the firm and key informant interviews, private financial banks see the manufacturing sector as very risky. And as far as there is easy money to be tapped in the service, wholesale and retail sectors, why would private banks finance the manufacturing sector?
- b) High collateral requirements – those that allow limited manufacturing financing, they require investors a huge amount of collaterals. The collateral requirements are usually high that firms can't raise easily.
- c) High interest rate – the private sector also charges high interest rates.

(ii) Access to foreign exchange

The current foreign exchange regulation fully liberalizes current account for international payments. The regulation allows payments for all kind of imports with the exception of goods that are supposed to be detrimental to the health of the public and security of the nation.

Payments for imports can be made by Letter of Credit (LC), Cash Against Documents (CAD) and advanced payment (TT). Although the National Bank of Ethiopia is responsible for legal framework, commercial banks handle the foreign exchange demands requested by importers. Importers are required to provide import license, industry license/investment license accompanied by proforma invoice or contracts from suppliers stating the type of commodity, quantity of the good, unit price and FOB value.

Importers can get the amount of foreign currency that they requested for their imports based on the foreign exchange allocation procedure. The Commercial Bank of Ethiopia has setup a committee to approve foreign exchange requests according to an expert in the bank. There is some element of prioritizing inputs for the manufacturing sector, fuel and pharmaceutical products. Experts at the Commercial Bank of Ethiopia also stated that they serve client on first-come, first-served basis.

Long queue

However, investors complain that there is Lack of transparency in the foreign currency allocation process. It is not possible to know how long it will take (there is a queue). The process can take anywhere from three months to one year. As the investor is unsure about when her/his request will be approved she/he has always to be ready. This process ties up capital that would have been used for other purposes. The long waiting time means prices (including the exchange rate) will change increasing the cost of waiting.

Requirements

Previously in order to get foreign currency, firms were supposed to save 50% of the total amount of money they acquire. Currently, it is made 100%, they have to deposit 100% of the cost to the bank. They deposit the whole money and wait minimum of three and maximum of one year. It is stated that they would have done other side business with the money until they got LC.

The other issue was that, formerly firms used to submit their proposal/Performa in different private and government banks at the same time just to take advantage of getting earlier. But now it is made only to submit in one bank may be government or private. This reduces the chance of getting LC earlier.

Corruption

Some investors have mentioned the case where the lack of transparency in the allocation of foreign currency has led to the emergence of corrupt practices by officers working in banks.

6.4. Customs services

Customs plays a role in ensuring the business competitiveness of the country, contribute to revenue collection and provides social protection. It is also used to as a policy instrument to support the structural transformation agenda. Customs rate applicable to various imports range from 0 to 35 percent depending on the type and purpose of imports. In addition, there are various incentives that investors can enjoy when starting their businesses such as a full exemption of duties on capital goods such as machinery and equipment imports and spare parts worth 15% of the imported capital goods and income tax exemption ranging from one up to three years (Council of Ministry Regulation 84/2003). In addition, favorable duty rates are applicable on intermediate inputs compared the higher rate levied on final goods.

The incentive provided for domestic investors are considered rather generous by investors. However, there is some concern that it applies blanket rather than tailored incentives. For instance, the investors we interviewed raised the point that the types of vehicles that can be imported duty free does not necessarily meet the requirements the specific sector the investor is engaged and are rigid. The challenge is mainly in the implementation of the aforementioned incentives in practice. Another major problem in relation to Customs is the time it takes to get clearance for intermediate inputs. Our interview with businesses reveals that part of the problem is the lack of qualified customs officers to inspect and give decision promptly. Consequently, valuable time is lost until the customs officers establish whether an imported item is a final good or an intermediate input. This is faced usually before starting operation but also by those who have moved in operation. Needless to say, the protracted delay hurts investment projects in many ways. There are those who have complained that the items have been spoiled or damaged during the waiting time at customs and the investors will bear the cost. For those that are in operation, it can distort relationship with their client and tie scarce resource. It is also reported that the way the imported item stored is also another factor leading to wastage.

Other issues in relation to customs are the frequent change in procedures that create uncertainty and hinder trade facilitation, corruption as a result of unclear procedures, and the customs valuation procedure. Customs valuation is the method of establishing the value based on which customs rates will be applied. In Ethiopia, invoice value will not be accepted if it is considered too low compared to a database maintained by Ethiopian Revenue and Customs Authority. Some investors complain that their invoice is rejected wrongly. The challenge for the government side is that often the custom related privileges are abused and even investor admits that there are those who abuse the system.

For manufacturing, lack of qualified professionals who understand the sector has been cited as a serious problem in various public bodies including customs office. This is particularly true as new industries are coming up. Investors feel that staffs in public bodies lack the required skill to evaluate manufacturing projects and this has lead them to make conclusion based signals such domestic or foreign investor. As a result, domestic investors feels that are considered less reliable and foreigners receive favorable treatment. Most officers shy away from responsibility so decisions are made based on previous practices or a decision is made jointly (as a committee). This will further delay the process from the investors' side.

6.5. Labour: Skills, Discipline and Turnover

In terms of industrial skills development, the last two decades have shown remarkable progress in terms of:

- (1) the rapid expansion in primary education, which is good for national movements in quality improvement, mind-set change and rural transformation;
- (2) TVET and secondary education expansion, which are linked with industrial productivity;
- (3) the establishment of industry institutes (TIDI, LIDI, MIDI, EKI, etc), which are crucial for industrial upgrading and producing sector specific skills;
- (4) the expansion of higher education in general and science and technology in particular to improve the supply of basic skills highly needed for economic transformation

Despite all these improvements, investors in Addis Ababa still complain about at least three issues regarding industrial labour:

(i) Labour skill

Industrial human capital as a set of skills/characteristics increases workers' productivity. By industrial labour, we are referring to manpower specializing in industrial issues or industry specific knowledge/skills. Modern factories require high skilled and qualified workers. As Ethiopia (especially Addis Ababa) transitions from traditional and small scale firms to large and technologically driven modern factories, the shortage of skilled workers started to become serious. The gap between the skill levels that existed in the endogenous traditional sectors and those required in emerging modern industries is very wide. The essence of work skills on the shop-floor of the modern factory is to integrate the operational skills and the ability to cope with various irregularities, such as machine breakdowns, the need to modify tools and programming and the need to adjust to unforeseen circumstances (Koike and Inoki, 1990; Wolf 2004). More skilled work-force is (almost by definition) more likely to be productive because they can correct problems before they affect output; understand what consumers want; and suggest and introduce improvements.

Obviously private firms underinvest in skills development and hence creating and maintaining an abundance of skills has been hard as moral hazard problems create strong disincentives for employers to invest in training. This is a classic market failure, where firms are unable to recoup their investments in labour training. As a result, the state, through its formal, vocational, technology and industry institutes, has been producing the required industrial skills. The recent shift in Ethiopia's education policy that 70 percent should go to science and technology and 30 percent to social sciences and humanities is an attempt to address the shortage of industrial skills. Despite these efforts, significant number of firms expressed that there is significant shortage of skilled labour in the market. New graduates don't have the required skills that they can immediately apply upon employment. Some firms try to solve this problem by providing complementary on-the-job training to their workers. An investor described the problems as follows:

I installed new machineries but I could not find workers who could operate the machineries.

Public private dialogues or industry-academia linkages can offer a crucial opportunity for the government to know what industrial skills are demanded by the industrialists, and produce these skills in universities, colleges, TVETs and industry institutes accordingly.

(ii) Labour discipline

The second problem relates to labour discipline. Labour should not only be trained but it should also be disciplined. Some of the major discipline problems firms face include the following:

- Time management - workers come to their work place late and leave early.
- Significant and repeated absenteeism especially during Ethiopian holidays without notice – according to firms we interviewed, a typical worker enjoys ungranted leave for at least three days – eve, holiday and one day after the holiday. This a common practice in public offices, and it usually unpunished.
- Unwillingness to work for extra hours when the factory has pick demand. Workers perception is that investors pay less in wages especially when it is over time.
- Lack of industrial culture (management and work ethics) – the relationship between management and workers seems to be rough. There is no institutionalized regular communication and information flow between top management and employees. Such institutionalized communication is a crucial medium for workers to ask questions, report problems to their bosses and make any suggestions. On the other hand, it also helps top management address workers’ questions and concerns systematically, convince workers to embrace new ideas and changes and get involved in the process.

The lack of discipline also comes in the form resistance, cheating and regular complaints. One of our respondents said:

I can say that whatever you do to satisfy the employees’ needs, many of them are not free of complain and cheating. For some of them, this is because they think that investors become rich not by working hard but through corruption or cheating of government or other incentives. For this reason, many of the workers think about the short cut to become young investors. Competition from other business is another problem that can create bad manner and persistent request for salary increment

(iii) Labour short-termism and job hoping

According to investors, the manufacturing sector suffers from recurrent job-hopping and short-termism partly because workers believe it is a low-paying sector (especially for production workers) and partly because it requires significant skills and discipline. As Addis Ababa is a quickly urbanizing city, the service sector is growing rapidly and tends to pay better than the manufacturing sector. In addition, there are a lot of NGOs and international organizations that offer better pays. As a result, young workers do not settle for long in factories. They change jobs frequently. This makes production at full capacity difficult and increases the cost of training new workers every time.

6.6. Regulatory environment

(i) Labour laws

There is a strong argument that Ethiopia's labour law is strict in the sense that it overprotects workers and impedes industrial growth and employment creation. The laws are designed to protect workers from discriminatory and unfair practices of employers. They intend to protect workers against job insecurity, poor working conditions and low wages. Labor legislations stipulate minimum benefits that accrue to workers and restrict the rights of hiring and firing, thereby raising labor costs and affecting productivity and competitiveness.

Most firms we interviewed believe that the law works for only the labor. When disputes arise, the law favors workers. In almost every dispute, workers win. This has opened doors to bad behavior on the part of workers since they believe that the law protects them. They tend to abuse the law. On the other hand, worker feels that manufacturers pay quite less. They work for longer hours but are paid less than what is paid in other sectors. Especially when they work over time on holidays and weekends, they payment is quite small. Workers sometimes refuse to work on holidays and Sundays because they believe it is not worth for the salary the manufacturers pay them.

(ii) Regulatory rent

The fact that there are shortage of supply of foreign currency, land and finance opens door to rent-seeking behaviors. Since getting access to land, foreign currency, finance, power, etc through the standard procedure takes a long time, firms try to get access through short-cuts by capturing the system and paying bribes. Why corruption? Most investors use informal and illegal ways due to the bureaucratic procedures and ineffective customer service. When investors try to fight for legal rules and procedures by exposing inefficiency and corruption, they become vulnerable/victims. Whistleblowers are not protected. Firms assumed that bureaucratic and delayed customer service is the main source of corruption. As a result, they give bribes just to make their assignment easier and faster. Regulatory capture and corruption has become a consistent problem in the city administration.

7. Unlocking the city's opportunities and solving the constraints: Key recommendations

Sections five and six discussed the challenges at different stages, namely, pre and post operation periods of investments. Our results are based on face to face interviews with businesses at various stages in the investment processes, and key informant interviews. However, we also attempted to triangulate the findings from the firm and key informant interviews using various secondary sources and studies. Our sample includes those that have gone through all the process from investment license all the way to production and become operational; those have given up on the project; and those that are in process. The firms are engaged in various sectors of the economy ranging from manufacturing sector, hospitality sector, consulting firms etc.

This section synthesizes the key investment barriers and teases out possible recommendations to unleash the city's opportunities and address the key constraints and market failures that are identified in sections 5 and 6 – especially on the key issues of land, finance, industrial skills and institutional and regulatory issues in both pre and post operation phases. Our recommendations also distinguish between recommendations that are relevant at the city and federal level for clarity and ease of implementation.

7.1. Land - Summary of the challenges and suggested solutions

(i) Synthesis of the challenges

We have interviewed investors who quit their investment and those continue and become operational regarding main challenges they face in their investment process. Both type of investors have indicated that access to land as the most crippling constraint for investment in Addis Ababa. Many of the investors who cancelled their investment have attributed largely to the lack of land access. Access to land and working premises is also bottleneck for investment expansion. The demand for investment land in Addis Ababa is so big. Currently it is estimated that about 6000 investors are in a waiting list requesting land for investment. However, the land supply is limited. This has created big distortions in the land and rental market and price hike.

In Addis Ababa, there are at least three main modes of access to land for business purposes; (i) leasehold, (ii) purchase or rent from private premise, and (iii) access to publicly/municipally owned rental business premise. The lease-hood is in turn made in three forms: tender, allotment and special tender. The tender is supposed to reflect available market transaction value, thus, every type of business can take part. Allotment refers to land allocation without tender and most of the eligible activities under this category are public services. The only private economic activity given privilege under “allotment” is the manufacturing sector. Private sector investments rendered under “special tender” are higher education institutions, hospitals, health research institutions, four-star and above hotels and mega real estates.

Even if the manufacturing sector receives priority and special attention in the land allocation by the rule, in practice there are many challenges. The first is delay in decision making. According to the respondents, land allocation decisions take very long time, from 3 to 7 years. In Addis Ababa, the land allocation decision and particularly “land allotment” is made by the city cabinet based on proposal by the land development and management bureau. However, the cabinet meets rarely and decisions are often late. The purpose of centralized decision making was to reduce the mismanagement and corruption in land allocation. But it does not look serving its purpose of controlling corrupt practices. The respondents’ perception is that by increasing the time for decision it creates inefficiency in the land allocation leading to frustration among the investors.

The city administration argues that the delay is not at the level of cabinet but at the stage before that, i.e. screening and preparation by the land administration.

The respondents also raised serious issues with regard to the land allocation through bidding. The bids are not transparent and land is often given to those that have connections and pay large sum of bribes. The size of land that is available in each tender is very small in comparison to the demand. The limited land supply coupled with discretionary power of the government officials to restrict, tighten or widen access to land creates a large rent, thus, attract more speculators into the bid. The administration is not able to differentiate the speculators from the genuine investors. The bid process is largely dominated by the speculators, which tend to increasingly bid with high price unaffordable by the genuine investors. The speculators retain the land for some time and resell the use right of the land at even higher prices. This has proven to be discouraging to the genuine investors and the productive sectors.

In fact, according to the respondents, the bigger headache is the time that takes in implementation stage, i.e. transferring the land to the lessee once decision is made. The land transfer is marred with inefficient bureaucracy – long queue, repeated appointment, unable to meet busy officials due to too many meetings. The investors complain that they are required to deposit a large sum of money (some say about 30%) to have access to land. This and in combination to the delayed decisions tie up a large sum of their investment capital. Delay in land development investment permits also lead to delay in construction and request for renewal of permit again subject to arbitrary decision and corruption on the regulators side. According to the respondents corruption is rampant and informal fees are institutionalized.

According to World Bank (2012) study land allocation is the second most area of corruption in Ethiopia following customs services. The most corrupt activity in the land sector occurs at the implementation stage suggesting that the level of corruption is influenced by the way policy and legislation are formulated and enforced. The study identified serious gaps in the enforcement that include reliance on unpublished and easily changed directives, lack of real system to record rights and restrictions, ignorance of the master plan particularly green areas and roads in favor of private use.

The transfer of land use right is narrowly defined and in many circumstances causing fraud land transactions. According to the recent land proclamation for land to be transferred above 50% of the construction should be completed. But there is additional restriction on the value the lessee can obtain from transferring the land. The lessee can earn only the effected lease payment plus interest, value of already executed construction and 5% of the transfer lease value, while the remaining should be paid for the appropriate public entity. This is believed to have encouraged underground market and at the same time restricting the land supply for potential buyers. Another dimension of the land transfer problem is that some land allocated for priority sectors such as manufacturing at designated places and low price are used for other purposes, for example to construct stores and rent it. This is becoming common practice implying the weak monitoring and enforcement mechanism from the land administration side.

The investors perceive of a de facto discrimination against domestic (versus foreign) and small firms (versus large ones). Although the city government is working to address the land and premise problem of many of the small firms who graduate to medium size by the way of preparing industrial clusters with sheds, this is not yet fully implemented. The city administration has identified industrial areas in its master plan. These are mostly found off the center with less access to basic services, underdeveloped infrastructure and unreachable for customers. Some of these places are also occupied illegally for resident purposes. Thus, in practice land is not properly designated for different types of business and the master plan is often ignored.

In the absence of publicly-provided land, investors use their own land or buy/lease from private sources. The private lease transfer price (and rental of premise) is very expensive consuming large part of their investment and also sometimes uncertain due to changes in the prices of private holdings. Many of the investors stated that no investor needs to start business in a rental land unless and other wise he/she has more money to do that. According to the respondents, leasing from private providers also creates a big uncertainty because the landlords frequently increase rental price or force the tenants to leave the premises giving several reasons. There is also uncertainty about the legality of the lease/rent. Price setting is up to the land lord. Landlords often force the tenants to pay down payment for extended period of time, which reduces the working capital available for the investors. There appears no efficient contractual arrangement that binds both the supplier and customer. More importantly, the private rental is not an option

for many manufacturing activities that require large tracts of land.

(ii) Suggested solutions

We can address the challenges raised above by categorizing into certain major parts. The first challenge is structural and is related to the limited land supply. Addis Ababa is the seat of the federal government with nearly four million population. By constitution, it has certain geographical boundaries covering land size of 527 square km and is surrounded by the Oromia region. This means it cannot be expanded, thus, the supply of land the city administration can make available is limited. Another dimension of the land supply is the mono-route feature of urban land provision namely the municipalities. According to the constitution, land ownership in Ethiopia is exclusively vested in the state and peoples of Ethiopia. The private investor has the right to use, which may involve resell of user right and not the land. On the other hand, the city of Addis Ababa is the economic center of the country and is overwhelmed by an increasing investment demand. The municipality cannot cope with this increasing demand partly due to inefficiency and mismanagement.

The presence of increasing gap between demand and supply creates artificially high land price. This distorts the land and premise rental market, which in turn attracts more speculators while discouraging genuine investors. The high land and premises prices also translate into high living cost in the city and reduce the competitiveness of our industries. Tightening the land supply is also the source of windfall money in the land market and **has led to the emergent of oligarch group in the sector.**

One of the major **solutions is, thus, to improve the supply of land.** The first required change among the officials in the land administration is attitudinal. The municipality should not try to maximize the lease revenue by tightening the land supply but it should maximize the development impact of land. The tightly controlled supply of land for urban use has contributed to the record high prices of land. For instance, Addis Ababa has seen one of the world's highest lease prices, as demonstrated by USD 15,250 per square meter bid in December 2014 around Merkato. Monopoly power in land supply, unbalanced revenue and expenditure commitments provide strong incentives for the city administration to generate revenue from land sales.

However, this usually is not in line with long-term sustainable development goals and it may lead to wastage of land resources. In addition to more traditional responsibilities of managing municipal services, the city administration is responsible for economic development and job creation. A prudent allocation of land not only increases the supply of land but it also improves the development impact of land.

It is well-noted that the nation's as well as the city's priority in land allocation is to the manufacturing sector. Despite this, many of the investors interviewed identify the availability of land as major bottleneck. This is partly due to shortage of supply and partly due to bureaucratic inefficiency and corruption practices in land allocation. A quick way to fix the supply shortage for the manufacturing investment is to strictly implement the master plan and particularly develop the areas designated for industry. This can be addressed by pursuing the **industrial park development** approach already identified as the main route to industrial development at national level. Currently, the industrial park program is run at the federal level. The city administration has been creating industrial clusters for SMEs. However, given the acute industrial land supply shortage in the city, we suggest that the city should not be passive and boldly initiate its own industrial parks development not only to accommodate small businesses but also large industrial establishments. Industrial parks are likely to solve not only the land shortage problems, but also labor related problems such as the rising labour cost if especially industrial parks provide housing for workers because housing constitutes the largest cost for workers.

And yet Addis Ababa may not afford to meet every manufacturing investment demand for land given the limited land availability of the city. This means it has to make a choice among manufacturing investments and start to prioritize industries that do not require large spaces. There is also increasing pressure from the rising living cost in Addis Ababa, leading to high labor costs. Although the national direction of industrial development is anchored on labor intensive industrial sectors, the increasing living cost (and hence labour cost) is making Addis untenable for labor intensive manufacturing sectors. That means Addis Ababa needs to adjust its choices of sectors to accommodate these new realities. **Whether Addis Ababa should compete with other regions on the labor intensive and low value added sectors or shift its focus to high value added manufacturing activities and modern service sector is an important policy issue that needs to be debated.** In this regard, the city may consider the experiences of other big

cities in the emerging Asian countries regarding the evolution of economic activities and investments in an urban setting.

The manufacturing sector is not the only sector whose demand for land remains unmet. In fact, the largest demand is from non-manufacturing activities. The land supply to these activities is limited as well. The city can increase the supply for all economic activities in two more ways. We argue that better urban planning and reconstruction can significantly increase the land supply. A large part of the inner city of Addis Ababa is still underdeveloped and occupied by slum residential places. The city should, thus, develop the inner part of the city by providing quality infrastructure and also re-claiming land from the slum areas by building condominiums affordable by the average resident.

Another important solution to increase the land supply is to improve the efficiency of land market by easing the transferability of land use rights. As land is inelastic, the sustainability of supply can only be ensured by facilitating the private sales and resells of user rights in addition to the supply by the municipalities. The recently endorsed proclamation that restricts the value that could be retained by lessees on resell of their user rights has to be thoroughly evaluated if it had helped in tackling the rent-seeking in the land market as it was anticipated.

However, improving land supply alone cannot address the chronic land related problem in Addis Ababa. As shown above another major problem identified by the respondents is related to land administration and governance. Land allocation decision is slow and lacks transparency. Land transfer and implementation is also marred by huge inefficiency and corrupt practices. The regulations in many instances are excessive and inconsistent. They are also subject for arbitrary decisions and rely on unpublished and easily changed and manipulated directives. One has to knock so many doors to get things done as many agencies are involved in the process. Coordination between different agencies is weak. The civil service is incapable, less paid and less motivated.

Hence, another major task for the city administration should be to improve the land administration and governance. The regulations need to be made simple and clear. The government should improve transparency by providing sufficient information on time.

Institutions involved in the investment process should be streamlined and specifically the city needs to implement **a real one-stop-service** for investors. The **industrial park** scheme if applied properly can take long distance in overcoming the inefficiencies and rent-seeking related to land allocation and various investment permits. According to our discussion with the city authorities, there appears to be blurred relation between Addis Ababa and the Federal Institutions for example, between the Ministry of Industry and the Addis Ababa Industrial development Bureau (where the Addis Ababa Investment Agency is housed) with regard to duties and responsibilities. Although effort has been in place to strengthen individual property rights and develop basic legal and institutional frameworks, the city administration has to deepen the regulatory and institutional framework for land and modernize the land administration and management apparatus to support efficient and inclusive land development and allocation. This would include the implementation of modern land registry and cadastral systems, improved land transfer mechanisms (land titling, etc) and land use control mechanisms.

A related solution is adherent to the city master plan, which designates places to different uses. Full authority should be given for designated institutions overseeing the master plan and its enforcement. Authorities that violate this rule should be corrected and punished. The city should quickly apply the communication technology to digitalize its land bank and management. This will enhance transparency and reduce discretionary power. The city should also tightly control if an allocated land is diverted to other than the original purpose or misused. Not all investors are serious investors. There is a frequent practice of investors altering the use of land from industrial to commercial and other speculative purposes. Hence, modern land use control mechanisms need to be put in place.

More importantly, the city should work on reforming its civil service. Many of the government appointments including the land administrations need to be based not on loyalty but on meritocracy and trustworthiness of the civil servant. The civil service need not be taken itself as employment generator but facilitate the private sector investment to generate employment. In this regard, the civil service needs to be trimmed and efficient. The city needs to enhance ethics of service to the public (e.g., establish codes of conduct) and adequately compensate public servants in order to attract, retain and motivate qualified people.

Besides, government should introduce additional mechanisms to improve transparency and accountability, thus, build credibility in the view of investors and the public at large. In this regard, there should be strong complaint hearing and redressing mechanisms. There should also be a mechanism to protect whistleblowers (people who expose corruption, inefficiency and other malpractices) to increase transparency and accountability of authorities and processes. Authorities should be accountable for their wrong doings and credible actions should be taken and announced accordingly, and the city administration should provide access to information on land administration and management.

The domestic investors often feel discriminated compared to their foreign counterparts. Irrespective of whether this complaint is correct or not, the city needs to provide special support for domestic investors as they face many disadvantage in contrast to foreign investors. Domestic investors' financial and technological capability is lower and they are less experienced and less informed about the business they want to enter compared to foreign investors. The special support to domestic investors is justified not only on such weaknesses grounds but also on the multiplier effect they will generate to the domestic economy relative to foreign investors. At the end of the day Ethiopia's industrialization can only be sustainable in the presence of dynamic domestic industrialists and not FDI.

Another area, which needs the attention of the government is how to improve the regulatory environment of the land and work premises market. Private leasing of land (use right transfer) or working premise in Addis Ababa is extremely expensive and unregulated. A large part of the costs of many businesses working on rental premises is the rent they pay to landlord. While this creates a large and unreasonable rent for the landlord, the cost ultimately transferred to the final consumers exasperates the high living cost in Addis Ababa, which in turn pushes up labour cost. Ultimately, the high land and working premises cost means lower profitability and competitiveness of businesses. Investors who lease from private sources are also subjected to a lot of uncertainties emanating from frequent rent increase and evictions. These are found to cause business closures and discouraging new investment. The city should, therefore, regulate the private lease for land and premises in a way that facilitates smooth and predictable transactions.

7.2. Productivity enhancing factors - Summary of the challenges and suggested solutions

(i) Electric power

Synthesis of the challenges

Among the key infrastructures is electric power. The respondents have identified power supply as the most challenging of all infrastructures related problems. The power problem can be seen at two stages. The initial challenge is to get connected with the main grid. Investors are often requested to buy a transformer (or pay the cost of transformer to the EEPCO) at high price. There are other kinds of problems in relation to the electric transformer; long delay in the queue and poor quality of the transformers purchased. The majority of respondents agree that in both cases the bureaucratic hurdle is so serious and involves corruption practices from the EEPCO staff. Unless one takes a short cut through paying bribes, it will take up a year to get connected. On the other hand, the power sector problems in the operation phase are two. Firstly, is firms face frequent power outage. Continuing the power service also sometimes involve corruption. The investors confess that they had to pay bribes to get things done. Moreover, most investors are forced to buy generators to compensate the power outage, which adds up to the investment costs. Secondly, when industries expand their capacity or rent in residential areas, they need to upgrade their power to industrial level. This is another problem where corruption comes in, where they have to bribe to upgrade or wait for a long time.

Suggested solutions

The industrial park scheme can also help address the problems related to infrastructure as it provides the best infrastructure (i.e., power, road, water, etc.) in one area. That means that the city needs to give due emphasis on building industrial parks. However, this does not mean that industrial parks solve the overall infrastructure problems in the city. Not all manufacturing factories let alone other type of businesses are expected to locate in the industrial parks. Improving the overall infrastructure, thus, cannot be overlooked. One common manifestation of the poor infrastructure service (especially power) is inefficiency and corruption. Hence, the solutions suggested above to improve the civil service and other government entities (fighting

rent-seeking and corruption) can at the same time help improve the efficiency of the infrastructure and utility services.

It is well established that the electric power access and reliability is one of the major problems damaging investment not only in Addis Ababa but all over the country. Addressing this problem fundamentally may require, on the one hand, improving the efficiency of the sole power supplier, EEPCO, and on the other hand introducing competition into the power supply market. Although this is beyond the city's jurisdiction, it can at least have some say in the local power distribution administration and also facilitate good relation between the investors and the power service company. It is also in principle possible for the city to sub-contract the power distribution in Addis Ababa. But unfortunately as it stands the city is no better than EEPCO in service provision where it is the sole responsible for example, water and roads.

(ii) Entrepreneurial and Labor skills

Synthesis of the challenges

From the interview, we also found that investors are concerned about the lack of entrepreneurial and labour skills, which significantly affect the sustainability of investments and businesses.

Entrepreneurial skills: according to the interviews with the firms, lack of business knowledge and information is one important factor for many of the investment terminations. Some investors start business activities without having complete information and preparation. The project proposals they submit to investment bureaus are weakly prepared or copied from others merely to fulfill requirements. Lack of knowledge, skill and sound feasibility study about the type of investment is one of the causes for investment cancelation. They also lack information regarding alternative investments; marketing, type of machinery and equipment, and locations.

Labor skills: there is also significant shortage in the supply of skilled and qualified labor. Understandably the labor quality problem is more serious for the firms that started operation than for those that are in the pre-implementation stage. According to the interviews some firms started investment and got stuck at certain stages because they are not able to find qualified individuals to operate the machines and equipment. The lack of middle level management is another critical

problem.

In most cases graduates do not have the required qualifications. Firms are forced to provide on-the-job training incurring additional costs. But the main problem is not the cost of training but high labor turnover. The workers tend to leave the company soon after receiving the training in searching of better pay or as spin offs (to start own business). This affects the sustainability of their investment. This is a classic sign of coordination/market failure. Investors are also worried about the lack of labor discipline and work culture. Absenteeism, late coming, and early leaving are common problems which they assumed are manifestations of low quality of labor. The investors' perception in this regard is that workers from rural areas do better than urban youth. This may be due to fact that farming like manufacturing requires significant discipline and hard work and workers that come from rural areas have this experience. Lack of integrity and discipline from the workers side requires employers to engage in too much supervision, which is usually costly. On the other hand, employees claim for more pay due to the high living and commuting costs in Addis Ababa.

Suggested solutions

To solve the problem of entrepreneurial skills, investors need training and continuous advisory services on targeted skills such as entrepreneurship, marketing, management, customer and labor handling, import export process, custom process, taxation rules, and production techniques. Information services and sharing is also crucially needed. Training is needed to even diversify production – some type of on-the-job trainings. The city should, therefore, set relevant institutions and legal frameworks for Business Development Services (BDS) not only for small businesses but for all size categories.

The labour skill deficit, triggered by the coordination/market failure, must be solved by a collaborative action by the government and sectoral associations, where the costs of the training (producing industry level expertise) are shared among all firms and government. This is a common practice in many countries and seems to work well.

On the other hand, the high labor turnover and the lack of discipline should be addressed in collaboration with respective industries. Some of the major root causes of high labor turnover and lack of motivation are a perceived lack of fair compensation and mismanagement. Less motivated workers exert less efforts, thus, lower productivity. The private sector should be able to pay more for their workers to feel responsible and improve their productivity. Moreover, managers can create a culture of trust in their company by becoming role model themselves and putting clear and consistent rules how employees are rewarded. In other words, modernizing the management culture can also help improving the industrial relations and productivity. The city government can contribute toward this by way of entrepreneurial training and formulating regulations and directives that improve the work condition and compensations as well as peaceful industrial relations.

Finally, the city government should give due attention to the rising cost of living as this will erode the competitiveness of the cities industries. One major source of high living cost in Addis Ababa is high rental price of houses. This has caused the large number of laborers to live far from the city center and small towns in the outskirts of Addis. This involves long distance travel and high commuting cost. The government investment in low cost housing and modern public transport can help in reducing the living and commuting cost. However, government supply of low cost housing alone may not fully solve the chronic shortage of houses in city. Moreover, most of the laborers might not even afford to buy the condominium houses. The industrial park scheme if constructed with residential premises in side can be used to address this problem. The city government needs to promote the construction of residential places within the industrial parks that are envisaged to mushroom in the near future.

7.3. Finance – summary of challenges and suggested solutions

Synthesis of Challenges

Project finance/investment finance suffers the most in terms access to finance. Discussion with would-be investors have shown that securing loans for your investment for a newly established businesses one of the main problem that causes business to stall. This is because new businesses have limited interaction with commercial banks and most of the time have limited or no

collateral. Second lack of access to land also limits ability of business to borrow from the formal financial institutions.

Access to working premises as a constraint for accessing to finance

The main project financier, the Development Bank of Ethiopia, is said to favor foreign firms and large scale projects according to respondents. The problem of access to land faced by domestic investors also complicates the ability of firms to access loans from DBE. This is corroborated with our key-informant interview with DBE as one of the requirement is at least an agreement with the landlord for the period of the project to qualify for the loan. Hence, addressing the problem of sustainable working premises goes some way in solving the problem of access to project financing. This issue will also be faced by those who will seek finance from the commercial banks without land.

Financing requirement and Bureaucracy

DBE has a requirement as stated about that 25% contribution to the project cost in blocked account as a requirement. Investors feel that the deposit requirement in blocked account is excessive. The same issue has been highlighted as problem by DBE. The bank believes the inability to raise the necessary capital to meet the 25% contribution and the fact that the money is kept in blocked account is an issue with investors. But DBE feels that it has to protect itself for the possible risk. Investors describe the bank as too bureaucratic and the practice is different from the policy while the bank argue that it cannot avoid being bureaucratic for the simple reason that there is no collateral.

Commercial banks collateral requirement has been mentioned as one of the barriers that prevents startups for getting access to finance from the commercial banks.

As a suggestion, some investors believe it is important for DBE to have less risky interaction with investors (short term in nature and not necessarily project financing) to know them before embarking on project finance. The short term products are not an end in itself but it gives the bank the possibility to know their clients before taking a huge risk.

Some investors have also mentioned that focus from the government side has been on small and micro enterprises and the commercial banks and DBE focus on established businesses and mega projects respectively. This might lead to unserved medium enterprises, leading to the problem of

missing middle financing. As solution, DBE has a project in the pipe line which it refers as lease financing. The program targets medium level enterprises and plans to provide 80% of the project cost in terms of machinery. It is impossible to get the view of investor on the lease financing scheme as it has just started. We are informed that 8 billion birr is planned to be allocated to medium level enterprise through the lease financing scheme.

Access to foreign exchange

The current foreign exchange regulation fully liberalizes current account for international payments. The regulation allows payments for all kind of imports with the exception of goods that are supposed to be detrimental to the health of the public and security of the nation. Payments for imports can be made by Letter of Credit (LC), Cash Against Documents (CAD) and advanced payment (TT). Although the National Bank of Ethiopia is responsible for legal framework, commercial banks handle the foreign exchange demands requested by importers. Importers are required to provide import license, industry license/investment license accompanied by proforma invoice or contracts from suppliers stating the type of commodity, quantity of the good, unit price and FOB value.

Importers can get the amount of foreign currency that they requested for their imports based on the foreign exchange allocation procedure. The Commercial Bank of Ethiopia have setup a committee to approve foreign exchange requests according to an expert in the bank. There is some element of prioritizing inputs for the manufacturing sector, fuel and pharmaceutical products. Experts at the Commercial Bank of Ethiopia also stated that they serve client on first-come, first-served basis.

Long queue

However, investors complain that there is Lack of transparency in the foreign currency allocation process. It is not possible to know how long it will take (there is a queue). The process can take anywhere from three months to one year. As the investor is unsure about when her/his request will be approved she/he has always to be ready. This process ties up capital that would have been used for other purposes. The long waiting time means prices (including the exchange rate) will change increasing the cost of waiting.

Corruption

Some investors have mentioned the case where the lack of transparency in the allocation of foreign currency has led to the emergence of corrupt practices by officers working in banks.

Suggested Solutions

The problems in relation to finance are nation-wide in nature. However, limited access to land which is a major problem in Addis Ababa has created a constraint on the ability of firms to raise long term loans for their project. So addressing the issue of working premises (land) will also have a positive spillover effects. The importance of working premises does not have the same weight for every business type nor is it as simple as sector level distinction. For example, some in service sectors such the hospitality industry and medical facilities in the service will require working space and others such as consultancy may not.

As a country just starting to build the non-agricultural sector, there is a need for a system that will accommodate the financial requirement of new businesses. The lack of long term loans with less stringent collateral requirement for those that are just starting business could create a situation where informal markets fill the gap usually less efficiently (e.g. expensive loans). Although DBE has put project financing as its central objective, it is clear from the face-to-face interview many aspiring interview does not see it as a viable source of finance. DBE has to add to its portfolio medium enterprises as this will be crucial part of the country's and the city's future. Its image as a bank just serving foreign and government mega projects has to change. In order to do that the bank needs products that are targeted for the particular groups. The current lease financing scheme is a first attempt in the right direction. However, instead of putting large amount of funds for untested programs, it is important to experiment with smaller programs aimed at attracting successful medium enterprises in Ethiopia.

Finally, although shortage of foreign currency is likely to be a serious problem after starting operation it is also likely to be an impediment in delaying project implementation. Addressing the issue of limited access to foreign currency is linked with the country's macroeconomic policy at the macro-level. However, better transparency and the use of technology can help investor plan better. If for example, the rules are known and also if an investor is informed how many applications are ahead of him and how much on average this will take. It will give the investor to

plan better and use its finance accordingly. Most of the finance issues tend to resonate beyond the city capacity and hence the role of the federal government must be emphasized here.

7.4. Regulatory and institutional issues – summary of challenges and suggested solutions

Synthesis of the challenges

This section synthesizes issues including customs regulations, bureaucratic efficiency, and the regulatory environment.

Customs

Customs plays a role in ensuring the business competitiveness of the country, contribute to revenue collection and provides social protection. It is also used to as a policy instrument to support the structural transformation agenda. Customs rate applicable to various imports range from 0 to 35 percent depending on the type and purpose of imports. In addition, there are various incentives that investors can enjoy when starting their businesses such as a full exemption of duties on capital goods such as machinery and equipment imports and spare parts worth 15% of the imported capital goods and income tax exemption ranging from one up to three years (Council of Ministry Regulation 84/2003). In addition, favorable duty rates are applicable on intermediate inputs compared the higher rate levied on final goods.

The incentive provided for domestic investors are considered rather generous by investors. However, there is some concern that it applies blanket rather than tailored incentives. As an example, an investor raises the point that the types of vehicles that can be imported duty free does not necessarily meet the requirements the specific sector the investor is engaged and are rigid.

The challenge is mainly in the implementation of the aforementioned incentives in practices. One of the problem is the time it takes to get clearance for intermediate inputs. The interview with businesses reveals that part of the problem is the of lack of qualified customs officers to inspect and give decision promptly. As an example, valuable time will be lost until the customs officers establishes whether an imported item is a final good or an intermediate input. Even in cases where DBE has been the financing the project, such problems are unavoidable. This is faced

usually before starting operation but also by those who have moved in operation. Needless to say, that the delay hurts the investment project in many ways. There are those who have complained that the items have been spoiled or damaged during the waiting time at customs and the investors will bear the cost. For those that are in operation, it can distort relationship with their client and tie scarce resource. It is also reported that the way the imported item stored is also another factor leading to wastage.

Other issues in relation to customs are the frequent change in procedures that create uncertainty and hinder trade facilitation, corruption as a result of unclear procedures, and the customs valuation procedure. Customs valuation is the method of establishing the value based on which customs rates will be applied. In Ethiopia, invoice value will not be accepted if it is considered too low compared to a database maintained by Ethiopian Revenue and Customs Authority. Some investors complain that their invoice is rejected wrongly. The challenge for the government side is that often the custom related privileges are abused and even investor admits that there are those who abuse the system.

For manufacturing, lack of qualified professionals who understand the sector has been cited as a serious problem in various public bodies including customs office. This is particularly true as new industries are coming up. Investors feel that staffs in public bodies lack the request skill to evaluate manufacturing projects and this has lead them to make conclusion based signals such domestic or foreign investor. As a result, domestic investors feels that are considered less reliable and foreigners receive favorable treatment. Most officers shy away from responsibility so decision are made based on previous practice or a decision is made jointly (as a committee). This will further delay the process from the investors' side.

Bureaucratic efficiency, Regulatory environment and corruption

Bureaucratic efficiency is limited by the fact that the decisions made by bureaucrats involve rents to consumers. Using consumers' complaints about incorrect decisions, can become ineffective will have its own limitation (Prendergast, 2001). Therefore, we will use the investors' complaints with care in understanding the bureaucracies faced by investors. There various public offices that an investor need to visit before her/his investment project becomes operational. The easiest step

in the process is getting investment licenses. In general, the pre-implementation phase can be done very quickly.

Problem is concentrated when moving to the implementation stages dealing with land, customs, etc. At the final stage, before investor are able to start production for the market they have to obtain business license according to the commercial registration and business license proclamation. For some categories, obtaining the license require certificate of professional competence given by the concerned body of the government. The process of obtaining the business license involves showing the place of work, employees' profile and is open for malpractices. Business license has been described as formality and some even present profiles of employees that are not working with them. If bureaucracy is put in place, is important to observe that it is implemented correctly. Otherwise, it will create room for corruption and lack of respect for the institutions of the country. Specifically, in Addis Ababa officials are not always accessible to investors (because of meetings).

Corruption in general is gaining currency in various public bodies but it is particularly severe in areas of accessing power. But corruption is not limited to public bodies it is observed in private sectors such as commercial banks.

Suggested Solutions

On ***institutional inefficiency***, one of the key issues we discussed is the lack of complete information on the investment processes, the required documents, and the institutions they need to visit to process their applications. Firstly, the Addis Ababa city Investment agency should make available complete information about all investment processes both on public notice boards, leaflets and online so that investors know exactly what to do and where to go to process their investment applications. Secondly, the city administration can encourage the establishment of information bridging institutions that promote information availability. Thirdly, in terms of solving the bureaucratic inefficiency, which is partly due to low use better filing system and lack of digitizing, applying simple techniques such as the 5S (Kaizen technique) can bring quick results in organizing the work place in a much better way cutting the search time for locating files. A more long-term solution would be for the government to implement e-government in

attempt to digitize all processes. This will expedite processes and avoid corruption and inefficiency.

In controlling corruption, the approach has been to use the stick. Perhaps, adopting a mixed strategy which encourages and rewards good behavior and practices together with punishment of those in the wrong should be tried. Investors mention that salaries are very low and that makes corruption likely. This shows that even in the mind of the victim corruption is accepted. It is very difficult to fight corruption in this setting. On the other hand, here is also a need to evaluate the decision making process at various public offices. Particularly, the practice of accepting what has been done once as a rule or making collective decisions must be evaluated. In relation to this, inaction or indecision on the part of officers must not be tolerated.

On the other hand, different studies indicate that the major reasons that investors engage in corrupt practices is to avoid wasting time in lengthy process/procedures. Hence there is a need to streamline process and procedures as much as possible (one stop shopping is worth to consider). Institutions that are considered most corrupt should also be further strengthened and their operations closely monitored by the government using appropriate mechanisms.

Different studies on corruption also indicate that lack of evidence, perceptions that actions are not taken against corrupted officials and limited clarity about corruption proceedings are some of the most important reasons why corrupt practices are not reported to the relevant authorities. Therefore, the government should consider working on simplifying and facilitating reporting of corruption, protecting of those reporting corrupt practices, taking prompt public measures, organizing periodic consultation forums with investors to discuss on bottlenecks.

Assigning appropriate professional staffs and improving the capacity of institutions that provide services to the investors including infrastructures such as telecommunications, transport, electricity etc. is vitally important as they are basic requirements for business operations.

On regulatory problems, continually improving the capacity of the customs officers must be considered as the economy advances and issues get sophisticated. And the revenue authority has

to take some responsibility for goods/items damaged under its possession. Perhaps this will incentivize the authority to not hold up goods unnecessarily.

Matrix table of the proposed recommendations

Below we present a matrix table of the proposed recommendations. We think that it is helpful to try to identify those recommendations that are within the jurisdiction of the Addis Ababa City Administration from those that are within the Federal Government level. The table of recommendations also differentiates between quick wins and longer term solutions.

Proposed Solutions		Differentiating whether the recommended solution is within the remit of Addis Ababa or Federal government		Differentiating whether the recommended solution is a quick win or a longer-term one
		Within the Jurisdiction of Addis Ababa city government	National Level	
1. Land	a. The municipality should not try to maximize the lease revenue by tightening the land supply. It should rather maximize the development impact of land. There should be attitudinal change among the officials in the land administration in favor of the latter.	✓		Quick win
	b. Create more industrial parks. Industrial parks are likely to solve not only the land shortage problems, but also labor related problems such as the rising labour cost if especially industrial parks provide housing for workers because housing constitutes the largest cost for workers.	✓		Medium to long-term
	c. Gradually shift to land-saving investments (e.g., high value added manufacturing activities and modern services). Although the national direction of industrial development is anchored on labor intensive sectors, the increasing living cost (and hence labour cost) in Addis Ababa is not tenable for labor intensive manufacturing sectors. That means Addis Ababa needs to adjust its choices of sectors to accommodate these new realities. Whether Addis Ababa should	✓	✓	Medium to long-term

	<p>compete with other regions on the labor intensive and low value added sectors or shift its focus to high value added manufacturing activities and modern service sector is an important policy issue that needs to be debated.</p>			
	<p>d. Improve the efficiency of land market by easing the transferability of land use rights. Facilitating the private sales and resells of user rights in addition to the supply by the municipalities can increase land supply. The recently endorsed proclamation that restricts the value that could be retained by lessees on resell of their user rights has to be thoroughly evaluated if it had helped in tackling the rent-seeking in the land market as it was anticipated.</p>		✓	Quick win
	<p>e. Improve land administration and governance issues. The regulations need to be made simple and clear and reduce discretionary power. The government should improve transparency by providing sufficient information on time. The city should quickly apply the communications technology to digitalize its land bank and management. This will enhance transparency and reduce discretionary power. Institutions involved in the investment process should be streamlined and specifically the city needs to promote a real one-stop-service for investors. The industrial park scheme mentioned above if applied properly can also overcome the inefficiency and rent-seeking related to land allocation and various investment permits. One major part of the land</p>	✓		Quick win

	administration and governance aspect is civil service reform (discussed in more detail later under 'regulatory and institutional reforms')			
	f. Improve the regulatory environment of the land and work premises market. Private leasing of land (use right transfer) or working premise in Addis Ababa is extremely expensive and unregulated. A large part of the costs of many businesses working on rental premises is the rent they pay to landlord. While this creates a large and unreasonable rent for the landlord, the cost is ultimately transferred to the final consumer which exasperates the high living cost in Addis Ababa, which in turn pushes up labour cost. Investors who lease from private sources are also subjected to a lot of uncertainties emanating from frequent rent increases and evictions.	✓	✓	Medium to long-term
	g. Better urban planning and reconstruction can significantly increase the land supply. A large part of the inner city of Addis Ababa is still underdeveloped and occupied by slam residential places. The city should, thus, develop the inner part of the city by providing quality infrastructure and also re-claiming land from the slam areas by building condominiums that are affordable by the average resident. The city should also strictly enforce the city master plan, which designates places to different uses. Full authority should be given for designated institutions overseeing the master plan and its	✓		Medium to long-term

	enforcement.			
	h. The problem of finance is highly related to the problems of land. Limited access to land which is a major problem in Addis Ababa has created a constraint on the ability of firms to raise long term loans for their project. So addressing the issue of working premises (land) will also have a positive spillover effects.	✓		Medium to long-term
2. Finance	a. Domestic investors often feel discriminated compared to their foreign counterparts. Irrespective of whether this complaint is correct or not, the city needs to provide special support for domestic investors as they face many disadvantages in contrast to foreign investors. Domestic investors' financial and technological capability is lower and they are less experienced and less informed about the business they want to enter compared to foreign investors. The special support to domestic investors is justified not only on such weaknesses grounds but also on the multiplier effect they will generate to the domestic economy relative to foreign investors. At the end of the day Ethiopia's industrialization can only be sustainable in the presence of dynamic domestic industrialists and not FDI. The issue of discrimination against domestic firms is also true in land allocation. Hence this recommendation also applies for land.	✓	✓	Medium to long-term
	b. DBE has to add to its portfolio medium enterprises as this will be crucial part of the country's and the city's future. Its image as a bank just serving foreign and			✓

	<p>government mega projects has to change. In order to do that the bank needs to develop financial products that are targeted for the various industry groups and sizes. The current lease financing scheme is a first attempt in the right direction. However, instead of putting large amount of funds for untested programs, it is important to experiment with smaller programs aimed at attracting successful medium enterprises in Ethiopia.</p>			
	<p>c. Although shortage of foreign currency is likely to be a serious problem after starting operation it is also likely to be an impediment in delaying project implementation. Addressing the issue of limited access to foreign currency is linked with the country's macroeconomic policy at the macro-level. However, better transparency and the use of technology can help investor plan better. If for example, the rules are known and also if an investor is informed how many applications are ahead of him and how much on average this will take. It will give the investor to plan better and use its finance accordingly.</p>		✓	Quick win
3. Skills				
<p>i) Entrepreneurial skills</p>	<p>a. Prospective domestic investors need training and continuous advisory services on targeted skills such as entrepreneurship, marketing, management, customer and labor handling, import export process, custom process, taxation rules, and production techniques.</p>	✓		Quick win

		b. Information services and sharing is also crucial. The city should, therefore, set relevant institutions and legal frameworks for information sharing and Business Development Services (BDS) not only for small businesses but for all size categories.	✓		Quick win
ii) Labour		a. The labour skill deficit, triggered by the coordination/market failure, must be solved by a collaborative action by the government and sectoral associations, where the costs of the training (producing industry level expertise) are shared among all firms and government. This is a common practice in many countries and seems to work well.	✓		Medium to long-term
		b. On the other hand, the high labor turnover and the lack of discipline should be addressed in collaboration with respective industries. The private sector should be able to pay more for their workers and improve their productivity. Moreover, managers can create a culture of trust in their company by becoming role model themselves and putting clear and consistent rules how employees are rewarded and promoted. The city government can contribute toward this by way of entrepreneurial training and formulating regulations and directives that improve the work condition and compensations as well as peaceful industrial relations.	✓		Medium to long-term
		c. The city government should give due attention to the rising cost of living as this will erode the competitiveness of the city's	✓		Medium to long-term

	<p>industries. One major source of high living cost in Addis Ababa is high rental price of houses. The city government's investment in low cost housing and modern public transport can help in reducing the living and commuting cost. More importantly, the industrial park scheme if constructed with residential premises in side can be used to address this problem. The city government needs to promote the construction of residential places within the planned industrial parks that are envisaged to mushroom in the near future.</p>			
	<p>d. The industrial park scheme can also help address the problems related to infrastructure as it provides the best infrastructure (i.e., power, road, water, etc.) in one area. However, this does not mean that industrial parks solve the overall infrastructure problems in the city. Not all manufacturing factories let alone other type of businesses are expected to locate in the industrial parks. Improving the overall infrastructure, thus, cannot be overlooked.</p>	✓		Medium to long-term
4. Power	<p>a. One common manifestation of the power problem is inefficiency and corruption. Hence, the solutions suggested under 'bureaucratic inefficiency' to improve the civil service and other government entities (i.e., fighting rent-seeking and corruption) will at the same time help improve the efficiency of the power utility services.</p>	✓	✓	Medium to long-term
	<p>b. In the short term improving the efficiency of the sole power supplier, Ethiopian Electric Power, can ease the power</p>		✓	Quick win, medium to long-term

	<p>problem, but a more fundamental solution will be to introduce competition into the power supply market.</p> <p>c. Although it may be beyond the city's jurisdiction, the city government should not sit back and wait until things get better on their own. It can at least have some say in the local power distribution administration (within its remit) and also facilitate good relation between the investors and the power service company. If power distribution decentralization decision is made, in principle, it is possible for the city to sub-contract the power distribution in Addis Ababa. However, this does not guarantee efficiency because unfortunately as it stands now the city is no better than EEPCO in service provision, as can be seen from water and road services, where the city is the sole provide.</p>				
		✓			Medium to long-term
5. Regulatory & institutional inefficiency					
i) In controlling Corruption	<p>a. Reform the civil service - many of the government appointments need to be based not on loyalty but on meritocracy and trustworthiness of the civil servant. The civil service need not be taken itself as employment generator but as a facilitator of the private sector investment to generate employment. In this regard, the civil service needs to be compact and efficient. The city (and the federal government for that matter) should also raise salary and other benefits of the civil servant in order to attract, retain and motivate qualified people. Investors</p>	✓	✓		Medium to long-term

	believe that civil servants' salaries are very low and this makes corruption likely. This shows that even in the mind of the victim corruption is accepted. It is very difficult to fight corruption in this setting. Hence, the solution must target both improving the salaries and incentives of civil servants and streamline process and procedures as much as possible (one stop shopping is worth to consider).			
	b. Introduce additional mechanisms to improve transparency and accountability, thus, build credibility in the view of investors and the public at large. In this regard, there should be strong complaint hearing and redressing mechanisms. There should also be a mechanism to protect whistleblowers (people who expose corruption, inefficiency and other malpractices) to increase transparency and accountability of authorities and processes. Institutions that are considered most corrupt should also be further strengthened and their operations closely monitored by the government using appropriate mechanisms. Authorities should be accountable for their wrong doings and credible actions should be taken and announced accordingly	✓		Quick win, medium to long-term
	c. The city government has to reevaluate the efficiency the decision making process at various public offices. Particularly, the practice of committee (collective) decisions and the practice of accepting what has been done once as a rule. In relation to this, inaction or indecision on the part of	✓		Quick win

		officers must not be tolerated.			
ii)	Bureaucratic inefficiency	a. One of the key issues we discussed is the lack of complete information on the investment processes, the required documents, and the institutions they need to visit to process their applications. In solving this, the Addis Ababa city Investment Agency should make available complete information about all investment processes both on public notice boards, leaflets and online so that investors know exactly what to do and where to go to process their investment applications. Secondly, the city administration can encourage the establishment of information bridging institutions that promote information availability.	✓		Quick win
		b. In terms of solving the bureaucratic inefficiency, which is partly due to low use better filing system and lack of digitizing, applying simple techniques such as the 5S (Kaizen technique) can bring quick results in organizing the work place in a much better way cutting the search time for locating files. A more technology driven solution would be for the government to implement e-government to digitize all processes. This will expedite processes and avoid corruption and inefficiency.	✓		Quick win
iii)	Customs	a. Improve risk management system at ERCA to improve the slow customs and technical control clearance due to burdensome inspections procedures. It is also advisable to develop a specialized clearance regime for manufacturing companies.		✓	Quick win

	b. Continually improve decision making process by improving the capacity of the Customs officers and streamlining procedures and rules to match an advancing economy where customs issues get sophisticated every time.		✓	Medium to long-term
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