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# Korea's Cooperation Schemes to Development of Small and Medium Enterprises in Ethiopia

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**Sungil Kwak** Research Fellow, Africa Team and Regional Strategy Research Team, Center for Emerging Economies Research (sikwak@kiep.go.kr)
**Hyelin Jeon** Researcher, Africa Team, Center for Emerging Economies Research (hljeon@kiep.go.kr)
**Seukhoon Baik** Researcher, Regional Strategy Research Team, Center for Emerging Economies Research (shbaik@kiep.go.kr)

## Korea's Capacity for Supporting the SME Development of Aid Recipients

The growth of Small and Medium Enterprises (SMEs) has a critical impact on the economic development of a developing nation because it increases tax revenue and creates jobs. Korea strived for economic development in the 1970s, mainly through policies focused on the development of large enterprises, but great efforts were made also for the development of SMEs. The Small and Medium Enterprises Promotion Act (1979) were enacted to support the development of Korean SMEs. The support through financial institutions has also been provided such as the Citizens' National Bank and the Small and Medium Industry Bank. In 1984, the Mutual Assistance Fund was, moreover, established to prevent SMEs from going bankrupt and to finance joint purchases and sales. With the growth that ensued, Korean SMEs played a pivotal role in keeping the inequality down up until the 1998 economic crisis.

Korea has the sufficient capacity to support the SME development of developing nations due to a history of notable SME development. Nevertheless, Korea has, until now, largely neglected joint efforts in developing the SMEs of aid recipient countries. The Korean government must note that a number of developed western donors and multilateral organizations have realized the importance of SME development in achieving economic prosperity since the 1990s and that these countries have also engaged in a variety of joint SME development projects.

## Obstacles of SME Development in Ethiopia

The roles played by SMEs become more prominent as an economy grows. In a developing country, SMEs play the key roles of creating jobs, increasing exports and promoting market activity. For SMEs to play their important roles, they have to grow. There are, however, restrictive factors that prevent SMEs from reaching their full growth potential. In the case of Ethiopia, these restrictive factors have been identified as systematic inefficiency, shortages in human resources, R&D funds, and business sites, underdeveloped infrastructure and constraints to access financial services.

In Ethiopia, one of the world's poorest countries, the aforementioned restrictive factors negatively interact and become interlocked to create the biggest obstacle to SME development. Once this negative interlock forms, SME growth cannot be expected by eliminating just one of the constraints as other remained factors invalidate any achievement from the elimination. Michael Kremer's O-Ring Theory of Economic Development, a hypothesis of perfect complementarity between production factors, lends credence to the notion of this interlock of restrictive factors.

A comprehensive SME support policy is required to undo the interlock and devise growth of Ethiopian SMEs. For example, the Ethiopian government must improve SMEs' access to information and financial services and also implement comprehensive and systematic SME support policies, including policies for the distribution of required technologies and support of existing SMEs. To implement such policies, a standardized SME database will be necessary to be created and accumulated.

However, as the Ethiopian government lacks the financial capacity required to implement such policies, accurate selection and focus are required. Above all else, the Ethiopian government has to select the improvement of financial accessibility to support the establishment of new SMEs and the maintenance of existing ones. With sufficient capital secured, investments can be made in resources and SMEs can relocate to better locations.

## Ethiopia's Economic State and Achievements

Ethiopia achieved a double-digit economic growth rate in the second half of the 2000s. While such a high growth rate was, in part, a result of external support, it must largely be attributed to the Sustainable Development and Poverty Reduction Program (SDPRP, March 2002–May 2004) and the Plan for Accelerated and Sustained Development to End Poverty (PASDEP, June 2005–October 2009), executed by the Ethiopian government. Even though the SDPRP and PASDEP failed to achieve the envisioned industrialization, they nevertheless achieved dramatic economic growth as shown in Table 1.

**Table 1. Ethiopia's Economic Growth Rate and Gross National Income (GNI)**

| | 2001 | 2003 | 2005 | 2007 | 2009 | 2010 |
|---|---|---|---|---|---|---|
| GNI increase (% per year) | 8.18 | -1.92 | 11.47 | 11.11 | 9.01 | - |
| GNI | 500 | 490 | 630 | 800 | 950 | 1,030 |

Note: GNI is based on PPP (purchasing power parity).
Source: World Bank (http://databank.worldbank.org)

The SDPRP and PASDEP achieved not only economic growth, but also progress in various other fields of social and economic development. For instance, the net primary school enrollment rate sharply increased from 35% in 1999 to 86% in 2011. An increase in net primary school enrollment rate helps accumulate human capital to enhance labor productivity in turn. Moreover, basic knowledge of hygiene acquired in elementary school improves household health. It can be said that an increase in elementary education provides a vehicle for escaping multidimensional poverty through the development of human capabilities.

## The Ethiopian Government's Industrial Policies for Micro and Small Enterprises Support

After realizing the importance of micro and small enterprises in economic development and job creation, the Ethiopian government formed the Micro and Small Enterprises Development Strategy (MSEDS) in 1997. However, the execution of this strategy at the time was met with difficulties because it was managed entirely by the Federal Micro and Small Enterprise Development Agency without any regional executing bodies being formed. To address this issue, the Ethiopian government formed the Regional Micro and Small Enterprise Development Agency to perform the function of job creation and poverty reduction in each region. The MSEDS was revised in January 2011 to be more specific and comprehensive.

The revised MSEDS aims to develop micro and small enterprises to create a competitive and multi-faceted foundation for industrial development. Some of the devised strategies are vocational training, loans, equipment rental, administrative service development, market development and marketing support. The five fields of manufacturing, construction, commerce, service and urban agriculture were designated as MSEDS priority industries.

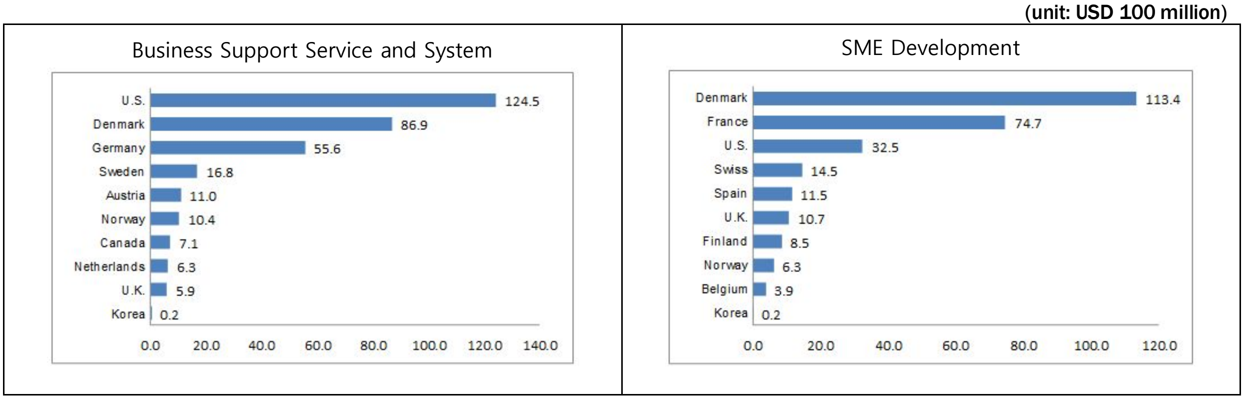
Furthermore, the Growth and Transformation Plan, executed in 2010, specifies in its Trade and Industry section the objective of creating three million jobs, developing 10,000 vocational trainers, vocational training of the hired 3 million employees and creating a 15,000-hectare site reserved for micro and small enterprise buildings.

## Support of African SME Development by Korea and other Donor Countries

Contributions made by DAC (Development Assistance Committee) members toward the development of African SMEs increased from USD 54 million in 2006 to USD 280 million in 2010, an increase from the amount initially agreed on by approximately five times. This took place after donor countries agreed with the notion of SME development contributing to Africa's poverty reduction and economic growth. Between 2006 and 2010, Korea increased its official development assistance (ODA) of African SMEs by approximately two times, but the total value of support provided thus far is insignificant compared to other donor countries. Figure 1 shows the commitment of ODA for the development of African SMEs by key DAC members for the year 2010. As an emphasis was made on private investment and improved financial accessibility of the poor as a means of achieving private sector growth at the 2010 G-20 Seoul Summit, the Korean government should take interest in supporting the development of Africa's SMEs in to develop the region's private sector.

**Figure 1. Value of ODA Provided by Donor Countries for African SME Development in 2010**

(unit: USD 100 million)




Source: Code 25010 (Business Support Service and System) and Code 32130 (SME Development) of OECD. StatExtracts, Credit Reporting System

## The Present and Future of Ethiopian SME Development Support by Donor Countries and Korea

The key donor organizations working in Ethiopia to develop its SMEs are carrying out tasks of value chain/cluster formation; investment/trade environment improvement; financial accessibility improvement through small loans and official financial institutions; and market accessibility improvement. For individual businesses, vocational training and personal development programs are being offered. Although such a wide variety of tasks are being performed, the members of the Development Assistance Group (DAG) are communicating with each other to avoid having multiple members provide assistance in a single area. For example, the U.S. government attempts to improve financial accessibility of small enterprise operators by granting them loans for mid-term investments and business startup through commercial banks, the national financial institutions. On the other hand, the German government helps Micro Finance Institutions (MFIs) receive loans from banks, the national financial institutions, by acting as a guarantor for up to 50% of an issued loan.

Korea's ODA of Ethiopia's SME development thus far has been on a small scale and is mainly focused on the provision of advisory service. In addition, the support that Korea provides to Ethiopia has all been independent activities and no synergy with other donor countries has been achieved. For instance, the Knowledge Sharing Program, started in 2011 for SME development in Ethiopia, is similar to projects that have already been executed by key donor countries. In Ethiopia, clustering of SMEs is being achieved through its value chain and cluster formation project; technical and administrative training is being provided through Japan's Kaizen Project; and networking of universities and research institutes is being achieved through the university reformation project of the German government-owned Gesellschaft für Internationale Zusammenarbeit (GIZ, or German Agency for International Cooperation).

Therefore, Korea needs to actively cooperate with donor countries that are active in Ethiopia and expand its areas of support. Because the need to develop the private sector as a means of poverty reduction and sustainable economy development was brought to attention at the 2011 High-Level International Forum on Aid Effectiveness, Korea must increase its support of Ethiopia's SME development.

## Cooperation for the Development of Ethiopian SMEs

One scheme is the support of Ethiopia's microfinance. The biggest obstacle Ethiopian SMEs face is limited financial accessibility and a shortage of human resources and R&D funds. Microfinance institutions provide non-financial services that can solve all of the aforementioned issues. As other donor countries are already carrying out microfinance projects in Ethiopia, Korea should utilize its advanced IT and ICT to improve Ethiopia's non-financial services. To improve Ethiopian microfinance institutions' capacity to provide non-financial services, Korean financial institutions and SMEs should act as private-cooperation partners. For example, Korean financial institutions can suggest the new financial products and provide customer management consulting to Ethiopian microfinance institutions from a Corporate Social Responsibility (CSR) perspective. Korean SMEs can also fulfill its CSR by making donations or sharing the technologies required to create value chains.

Another scheme is the joint execution of a SME development program with other donor countries. While the Korean government is seen as having implemented economic growth policies based primarily on large enterprises in the past, rigorous efforts were made starting in the second half of the 1970s to do away with the inequality between large enterprises and SMEs. Any areas of SME development in Ethiopia overlooked by other donor countries should be identified based on Korea's own past experience and the DAG working group should be consulted to make a contribution to the collective SME development program taking place in Ethiopia. The implementation of these schemes will improve Korea's overseas development assistance capacity as well. KIEP