



Scoping Assessment of the Ethiopian Financing Sector

About EnDev Ethiopia

Energising Development (EnDev) promotes sustainable access to **modern energy services** for households, small and medium enterprises, schools, health centers and community centers in developing countries as a means to inclusive social, economic and low carbon development.

These three impact areas translate to three action areas:

- (1) Energising Lives
- (2) Energising Opportunities
- (3) Energising Climate

EnDev **grows and strengthens markets** for modern energy services and products at scale, in particular for the poor, ensuring no one is left behind.

EnDev seeks to stimulate **social and economic development**.

The **Programme Energising Development** Ethiopia (EnDev) supports a sustainable supply of energy services to lower-income households, social facilities and small to medium sized enterprises with a focus on rural areas.



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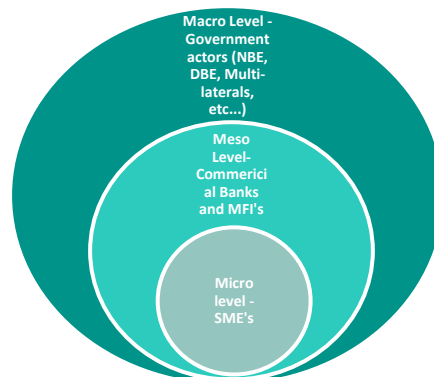
ACRONYMS AND DEFINITIONS

IT	Information Technology	MHP	Micro-hydropower
AECF	Africa Enterprise Challenge Fund	mio	Million
AfDB	African Development Bank	MoWIE	Ministry of Water, Irrigation and Energy
CEO	Chief executive officer	NBE	National Bank of Ethiopia
COO	Chief operating officer	NEP	National Electrification Plan
CRB	Credit Reference Bureau	NGO	Non-governmental Organization
DBE	Development Bank of Ethiopia	NRC	Norwegian Refugee Council
DFS	Digital financial service	PAYGO	Pay As You Go
ECCA	Ethiopia Clean Cooking Alliance	PV	Photovoltaic
EEA	Ethiopian Energy Authority	RBF	Revenue based financing
EEP	Ethiopian Electric Power	ROSCA	Rotating savings-and-credit associations
EEU	Ethiopia Electric Utility Company	RuSACCO	Rural Saving and credit cooperatives
EIC	Ethiopian Investment Commission	SACCO	Saving and credit cooperatives
EnDev	Energising Development	SHS	Solar Home System
EODB	Ease of Doing Business	SME	Small and Medium Enterprise
EPC	Engineering, procurement, and construction	SMEs	Small and medium-sized enterprises
ERG	Ethiopia Resources Group	SNNPR	Southern Nations, Nationalities and Peoples' Region
ESCOs	Energy Service Companies	ToR	Terms of Reference
ESMAP	Energy Sector Management Assistance Program	UrSACCO	Urban Saving and credit cooperatives
ETB	Ethiopian Birr	USA	United States of America
EUR	Euro	USADF	United States Africa Development Foundation
FID	Foreign Direct Investment	USAID	United States Agency for International Development
Forex	Foreign Exchange (hard currency)	USD	US Dollar
FSD	Financial System Development	WB	World Bank
GERD	Grand Ethiopian Renaissance Dam	WEF	World Economic Forum
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH		
GOE	Government of Ethiopia		
GTP	Growth and Transformation Plan		
ICS	Improved Cookstoves		
ICT	Information and Communication Technology		
kWp	kiloWatt Peak		
L	Liter		
MFI	Micro Finance Institution		
	Micro-hydropower		

Introduction

This assessment provides insight into the Ethiopian Financial Sector and covers the opportunities and risks associated with the industry.

The assessment was carried out in 2020, when there was a high impact of COVID 19, a volatile Business environment, steadily rising demand for energy, and global imperatives, such as climate change and it tries to provide an insight into the Ethiopian Financial Sector with a sectoral overview of the players in the system on the micro, meso and macro levels:



The assessment also gives companies, investors, governments, and other stakeholders a deeper understanding of the market. While other stakeholders (i.e., development partners) have conducted market assessments this assessment analysed the Ethiopian government's current and planned directions towards the adoption of reforms in various direct and indirect areas of the national economy, particularly as it relates to bridging the gaps in financing mechanisms and programs in the renewable energy sector. These include changes to the investment regulations, fiscal environment, and business operations restrictions. It has also identified the main sectoral gaps and seeks to developed recommendations to bridge those gaps accordingly.

The assessment also serves as a baseline for EnDev Ethiopia's technical advisors to assist deploying modern energy technologies and services in Ethiopia and guide their continuing work in the sector.

1 EXECUTIVE SUMMARY

Having sufficient access to finance is an important determinant for the development of any enterprise functioning in any industry. In many developing countries less than half the population has access to formal financial services, and in most of Africa less than one in five households has such access. Lack of access to finance is often the critical mechanism that engenders persistent income inequality, as well as slower economic growth. Hence expanding access to finance remains to be an important challenge across the developing world, leaving much for governments to do. However, not all government actions are equally effective, and some policies can even be counterproductive. But financial sector assessments can be used to determine areas of improvement in regulatory and policy aspects enabling increased responsible access to finance.

This document will be focusing on an understanding of the linkages **between the financial sector and the energy access market** to support the establishment of markets for modern energy supply with a focus on rural areas. It assesses the challenges to access finance, gaps, opportunities and potential solutions in order to promote increased funding success in the energy sector. The assessment provides valuable insights into the Ethiopian financial sector, the energy access sector, the financing mechanism linkages, and the contextual juxtaposition of the rural population within this prism.

The assessment also gives an intensive overview of the different stakeholders from different angles by looking at

- What has been recorded so far by having a deep literature review (Chapter 4) and
- Review of the stakeholders in relation to the sector along with looking at the individual challenges they are currently facing (Chapter 5).

The findings of the assessment do not only corroborate what is already known, but also gained additional insights into the overall developmental direction of the Ethiopian economy, and the role of the financial sector therein.

Methodology adopted for the assessment	
	Literature review to gain a general overview of the financial sector in Ethiopia vis-à-vis the various actors within it
	Tailored questionnaire calibrated for SMEs, financial institutions and public institutions
	Direct in-person interviews in-country in Ethiopia, accompanied with some video platform interviews, as well as creating and disseminating a digital version of the questionnaire for stakeholder response

The Government has pledged to turn more and more towards the private sector to take a more leading role as the engine of economic growth. There is a definite shift towards the liberalization of economic sectors which were previously fully state-controlled. Good examples include allowing the private sector to invest in air transport and postal services, engage in the import and export of as well as the transmission and distribution of electricity partnering with the state. There is also some loosening of restriction in the PAYGO sector, allowing for non-bank actors to make payment collections, albeit without charging interest (this restriction will itself likely be loosened in the near future). There is a general widespread acceptance that foreign investors are a critical developmental component (hence the focus on industrial park development).

The key bottlenecks and hinderances to the overall development of a smoothly functioning financial sector in supporting access to energy in Ethiopia are (Chapter 6):



- Inability of non-local foreign investors to repatriate forex
- Inability of non-local foreign investors to participate in local distribution and retail
- Inadequacy of the local banking system (commercial & MFI) to understand and underwrite SMEs
- Stifling bureaucracy in the loan review & approval process
- Slow pace of reforms and restrictive regulatory environment

Within the context of the deepening financial sector in Ethiopia, and specifically with a focus on the rural population, the key linkage that needs to be nurtured and developed is a *telco-driven, fintech-platformed mobile system – inclusive of a true mobile money system*. This would awaken and unleash the spirit of the entrepreneurial segment of Ethiopia, help to bring down bureaucratic barriers, ease the payment and settlements environment, ease the cost of doing business and bridge the divide between the population and the governance system.

Such a system specifically would:

- Create a data-driven approach to rapid credit decision making
- Lower borrowing costs to SMEs and all other businesses, and lower the collateral burden
- Support / facilitate the operationalization of a credit reference bureau system for which the regulatory framework already exists in Ethiopia
- Close down the often-cited information asymmetry gap in the SME/Lender relationship
- Utilize AI to analyse proxy data-points and create a participant credit profile (e.g., payment of utility bills, utilization of airtime, frequency of top-up and amount per top-up, etc.). Such a system would become more robust over time as more data-points are included over a longer period, thus allowing for AI-driven predictive behaviour algorithms to be created and deployed.
- Allow for a smooth integration of SHS/PAYGO deployment and cost-recovery payment
- Allow for the deployment of the PAYGO system to other applications, such as clean cooking

In order to expand the electricity access to reach even the deep rural areas throughout Ethiopia, non-grid systems such as mini-grids and off-grid solar systems, must be encouraged and supported. For this approach to have effect, the rural electrification strategy needs to be enhanced with payment mechanisms as well as relevant checks and balances to avoid over indebtedness, unfair practices etc. to make it accessible and affordable for everyone.

The energy sector in Ethiopia

In November 2017, the Ethiopian government launched the NEP as an action plan for achieving universal electricity access nationwide by 2025. 65% of access provision is targeted with grid solution whereas 35% are expected to be sourced from off-grid solutions. NEP targets a grid connection roll-out program for scaling up connectivity and complimentary off-grid access program that will provide access to rural and deep rural households without grid connectivity. Both the on-grid and off-grid energy access targets envisage public and private sector participation to be achieved.

To date, however, only a handful of Lighting Global® solar kit distributors exist in the market, and only two mini-grids operators have been licensed to the date of this assessment. The improved cooking sector is not scaling, and energy efficiency measures are not being extensively promoted across the sector. If the goals set by the NEP are to be achieved, the sector needs to be reviewed to facilitate scale for the private sector.

If the goals set by the NEP are to be achieved, the sector needs to be reviewed to facilitate scale for the private sector as only two mini-grid operators have been licensed to the period of this assessment, the improved cooking sector is not scaling and energy efficiency measures are not being promoted across the sector.

The assessment categorises the challenges / barriers in the Energy financing sector under the major thematic headlines of constrained access to **Forex**, forbidding **Collaterals**, none conducting **Regulatory** Environment and heavy lethargic **Bureaucracy**.

Recommended measure to mitigate these hurdles (Chapter 8) are the introduction of a forex guarantee scheme and the utilization of internal forex reserves fund to resolve the chronic Forex challenges is recommended; introducing guarantee fund schemes, realizing the intended Credit reference bureau, introduction of receivable financing and all these with capacity building measures specially for the financial institutions is recommended to tackle the hindering collateral issue for SMEs. To tackle the regulatory hinderances and as well the heavy bureaucracy, extensive advocacy for a more enabling policy and regulatory environment, building the technical and technological capacities in the sector to embrace digitalization and advanced technology are recommended.

2 CONTEXT AND OBJECTIVE

Ethiopia has recently experienced upwardly trending economic growth, which has contributed positively towards poverty reduction in urban, and partially in rural areas. In turn, this has given optimism to the country's leadership, which has set a target of attaining lower-middle-income status by 2025. Ethiopia has the second highest population in Africa (approx. 112m)¹, only behind Nigeria. This gives it a great steppingstone to achieving even higher future growth if the government can continue to direct its resources and investments towards poverty reduction and job creation. As this process evolves, for now Ethiopia remains one of the poorest countries in Africa.

The Government of Ethiopia's economic development vision has been historically encapsulated in the government's Growth and Transformation Plan (GTP). The growth objectives of the first phase, GTP I (2011-2015), were revised to formulate GTP II (covering 2016-2020). GTP II lays out a plan for dramatic structural transformation, shifting from an agrarian economy to one more geared towards manufacturing and services, with the overarching goal of making Ethiopia a lower middle-income country by 2025. GTP II envisaged 11% average annual economic growth with an improved trade balance and higher foreign reserves. More recently, however, there has been a reduced commitment to the GTP II.

Ethiopia will focus on mitigating greenhouse gas emissions by expanding electric power generation from renewable sources for domestic and regional markets.

The private sector was intended to play an increased role in the economy under GTP II, and the new administration has signalled a reduced commitment to the state-led approach to economic management with the Homegrown Economic Reform Plan.

The GOE is also committed to building a climate-resilient green economy and reaching UN Sustainable Development Goals.

In September 2019 the Government of Ethiopia (GOE) unveiled its "Homegrown Economic Reform Plan" as a codified roadmap to implement sweeping macro, structural, and sectoral reform, with a focus on enhancing the role of the private sector in the economy and attracting more foreign direct investment. The ambitious three-year plan prioritizes growth in **five sectors, namely mining, ICT, agriculture, tourism, and manufacturing**. In December of 2019, the IMF approved a three-year, 2.9 billion USD program to support the reform agenda. The program seeks to reduce public sector borrowing, rein in inflation, and reform the exchange rate regime.

The challenges remain vast. Ethiopia's imports in the last three years (2017 -2020) have experienced a slight decline in large part due to a reduction in public investment programs and a dire foreign exchange shortage. Export performance remains weak, declining due to falling primary commodity prices and an overvalued exchange rate. The acute foreign exchange shortage² and the absence of capital markets are choking private sector growth. Companies often face long lead-times importing goods and dispatching exports due to logistical bottlenecks, high land-transportation costs, and bureaucratic delays. Ethiopia is not a signatory of major intellectual property rights treaties.

¹ [CIA World Factbook](#)

² The Ethiopian Birr (ETB) is not a freely convertible currency.

Some Key Challenges:

Key Challenges	Brief Description
A limited private sector	In Ethiopia, the government plays a large role in the economic and investment activity. The private sector has historically been a minor player. This induces limits to the country's trade competitiveness if it wants to interact more broadly with the wider region and global economy. A thriving private sector is also more suitable to withstand and adapting to external or internal economic shocks. The government aims to expand the role of the private sector through foreign investment and industrial parks to make Ethiopia's growth momentum more sustainable.
An overly prescriptive legislative and bureaucratic business environment	The business environment in Ethiopia is heavily regulated and bureaucratic, with several institutional layers that make private sector initiatives less competitive due to time and costs allocated to non-business related activities; at the same time, a vast grey market of low-quality products centered around "the mercato economy" in Addis Ababa creates unfair competition.
A heavily centralized and poorly capitalized financial sector	This is especially crucial as it pertains to the lack of availability of assets, liquidity and FOREX to banks and financial institutions that can only access funds through the national bank. In turn, this has negative consequences in terms of loans' availability to SMEs, and the rural population is significantly underdeveloped. For various reasons that are further analysed and discussed in this Assessment, there is a wide gap between the needs of SMEs and the availability of programs, instruments, and expertise to service the need.
A strong national trade deficit	Ethiopia is a net importer, with exports for the most part limited to agricultural commodities. As a result, the country has been facing severe foreign currency shortage, exacerbated by increasing external debt and rampant national inflation. As a result, importers face major challenges related to access to FOREX.
External shocks	Unfortunately, Ethiopia has also been experiencing the social and economic impact of the COVID-19 pandemic. The economic impact of COVID-19 includes the increased price of food, rising unemployment, slowdown in growth, and increase in poverty. The country has also been dealing with a significant locust invasion which is endangering food security of many rural inhabitants.

The **2019 World Bank's Ease of Doing Business report (EODB) ranked Ethiopia 159th out of 190 countries**; an improvement of two positions from that of 2018. The new leadership has a focused target to improve the country's ease of doing business ranking and has formed an inter-ministerial committee led by the Prime Minister to improve specific areas of the ease of doing business. The World Economic Forum (WEF) has identified burdensome customs administrative procedures, the high cost of logistics, and access to credit and foreign exchange as major challenges to small and medium-sized enterprises (SMEs) in Ethiopia.

▶ **The key task of this assessment was to explore the linkages between the financial sector and its ability to serve the needs of SMEs to serve the rural population and market in the expanding renewable energy sector.**

The assessment took a deep dive to review, analyse and understand the Ethiopian government's current and planned directions towards the adoption of reforms in various direct and indirect areas of the national economy, particularly as it relates to bridging the gaps in financing mechanisms and programmes in the renewable energy sector. These include changes to the investment regulations, fiscal environment, and business operations restrictions.

Access to financing is important for economic development and for the transformation of rural economies. Yet a substantial proportion of the rural population in Ethiopia remains either unserved or underserved. In addition, a large proportion of the population living in Ethiopia has no access to electricity.

3 METHODOLOGY

with desire to conclude the assessment in a short time and as well the logistical challenges related to the pandemic of COVID-19, the Assessment was approached as follows:

- **Two experts (one on ground):** in order to accelerate the execution of the assessment a locally based expert who understands the local context and has on-the-ground connections was used who also facilitated the in-person interviews.
- **Literature review:** relevant literature was collected and analysed to assess the status and prospective of sector development in Ethiopia, both from the energy and financial perspective, including a thorough review of the institutional framework applicable to it.
- **Double approach to stakeholders' meetings:** this included both a digital and traditional, both in-person and through virtual platforms, questionnaires for key stakeholders. More information about this approach is provided below.

3.1 Approach to questionnaires

To maximize the number of interviews with key stakeholders the following approach was adopted:

- Preparation and validation of three questionnaires, containing 10-questions each, for SMEs, financial institutions and public institutions, respectively.
- Digitization of the questionnaires in Google Forms® for sharing with all stakeholders identified, which were each validated by the Client; and
- Based on the number and quality of answers received, follow-up with some key stakeholders through virtual or in-person meetings, to complement and enrich the information received.

Thirty (30) stakeholders were invited via email to participate and offer their responses to the on-line questionnaire. It was anticipated, and validated, that there was a limited uptake via the digitized questionnaire approach. In response, a stakeholder mapping exercise was performed and direct outreach via email and/or telephone was conducted to obtain a quicker and more direct contact with targeted key stakeholders. All stakeholder meetings via all platforms were validated by the stakeholders themselves prior to release of the minutes for the assessment team's use. The validated minutes were assembled and analysed and provided a rich source of direct insight that informed subsequent key parts of this Assessment.







The questionnaire was designed to extract information from the respondents that directly tied into the assignment's Terms of Reference. Some stakeholder categories overlapped because they were in more than one category, e.g. Development Bank of Ethiopia is both a financial institution as well as a public institution. For the purposes of assessment reporting it was treated as a financial institution.

Type of questionnaire	Targeted respondents	Number Of respondents
Questionnaire set 1	SME	6
Questionnaire set 2	Financial Institutions	4
Questionnaire set 3	Public Institutions	1

3.2 Limitations of the Assessment

The subject matter under review of this type of assessment is often multi-layered, cross-sectoral and requires the synchronized engagement and participation of a wide range of players across the economic-political landscape wherever it is undertaken. On the other hand it is absolutely necessary for key stakeholders and their respective supports, internally and externally (e.g. the donor community) to have a good understanding, appreciation and acknowledgement of the existing challenges and utilize their collective information in order to address and begin to provide proactive and beneficial interventions to the targeted groups.

While carrying this assessment the following limitations were acknowledged:

-  **Respondent reluctance to engage:** This limitation is specifically associated with the digitized questionnaire response expectation. It was anticipated by the assessment team that there would be a subset of prospective respondents who may not be so willing to write down their thoughts. However, respondents are quite willing to have open and frank exchange of ideas in an in-person setting, which proved to be an extremely valuable source of information.
-  **Language barrier:** this limitation was also associated closely to the digital component of the questionnaire, whereby some interviewees are not comfortable with writing in English. In in-person settings it was easy for our team and stakeholder to understand each other.
-  **Access to email:** Also related to the digital component of the questionnaire but mitigated by in-person meetings. In several cases, however, there was no response to the email outreach and without telephone contact, the meeting opportunity could not be realized.
-  **Over surveying:** Several respondents mentioned that there was over surveying fatigue. This could have been an additional reason for several lack of responses to the email outreach.
-  **Desk Assessment limitations:** Because a desk Assessment format does not include a travel component, most information gathered and analysed is restricted to digital means, including any stakeholder interviews. In this particular instance the assessment team was fortunate due to favourable circumstances to have one of the team experts to be present in Ethiopia. This helped tremendously, especially with the in-person interviews as well as personal observation of the society in motion and drawing inferences from these observations.
-  **Time constraints:** Due to the short time window provided for the execution of this assessment, certain activities were limited in scope. These include:
 - Interviews sampling size is limited due to the time it takes to make initial contact with a stakeholder, and the subsequent scheduling of a meeting, which sometimes results in rescheduling etc.
 - The amount of literature reviewed is also limited by time as it has+ to be reviewed, synthesized and reported on. More time obviously results in more review. However, the assessment team felt that in-country presence was a rich complement to the literature as it not only corroborated several written pieces, but it also added new layers of understanding.

4 LITERATURE REVIEW

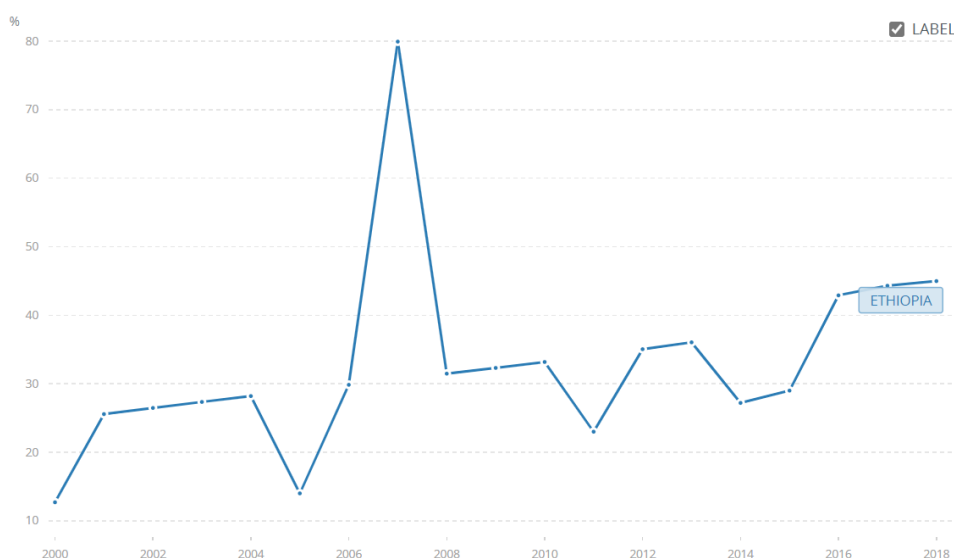
The literature review was thematically organized to gain deeper insight into the most relevant topics related to the assignment. The themes were as follows:

Accessing finance has been proven to be the major constraint facing small and medium scale enterprises (SMEs) worldwide (Ghosh & et al., 2017); (Bamfo & Asiedu-Appiah, 2012); (Lader, 1996). Small businesses, particularly in developing countries have limited access to capital markets partly due to perception of higher cost of intermediation for small firms (Mohanty, 2009); (Biekpe, 2004). In sub-Saharan Africa, many small businesses are not able to survive into the second year of operation due to lack of support from government and traditional banks (Biekpe, 2004).

The literature points to a series of market inefficiencies mostly due to lack of client understanding by the financial sector, especially SMEs and particularly so with regards to rural SMEs attributed to information asymmetry between lenders and borrowers, which affects households' access to financial services. In the case of credit, this problem is exacerbated by households' lack of collateral to pledge to access loans. Information asymmetry arises because lenders lack the information needed to screen the creditworthiness of potential borrowers and monitor them after granting loans. Also, serving poor rural communities geographically dispersed involves high transaction costs. Financial services, e.g. insurance and savings, are subject to the same challenges. In response, lenders require collateral that incentivizes borrowers to reduce non-repayment.

Access to financing is important for economic development and for the transformation of rural economies. Yet a substantial proportion of the rural population in Ethiopia remains either unserved or underserved. In addition, a large proportion of the population living in Ethiopia has no access to electricity. Approximately 46% of all Ethiopians use electric energy for day-to-day activities(Fehler! Verweisquelle konnte nicht gefunden werden.Figure 1).³ In the rural area, where 80% of the population lives, the population lacks a reliable, sustainable energy supply.

Figure 1: Access to Electricity (% of population) - Ethiopia



Source: World Bank Data. <https://data.worldbank.org/indicator/EG.ELC.ACCS.ZS?locations=ET>

Even though the government has a stated goal to make the national grid accessible to all by 2025, the rural population keeps increasing, and that by itself will make universal grid access a rapidly shifting moving target.

³ Source: World Bank Data. <https://data.worldbank.org/indicator/EG.ELC.ACCS.ZS?locations=ET>

With an access rate of 44 percent, the country faces the second highest electricity access deficit in Africa (over 60 million people without access) posing a binding constraint to economic growth and social development. The last-mile grid connections have not kept pace with infrastructure expansion.⁴

In order to expand the reach of electricity access to as wide a user-group as possible, non-grid systems must be encouraged and supported, such as mini-grids and off-grid solar systems (SHS). For this approach to have effect, the rural electrification strategy needs to be enhanced with payment mechanisms to make it accessible and affordable.

4.1 Small and Medium sized Enterprises (SMEs)

The literature review will delve into the pertinent commercial categories relevant for this assessment. Within the SME sector different players have different needs. The financing of small and medium enterprises (SMEs) has been a topic of keen interest in recent years because of the key role that SMEs play in economic development and their potentially important contribution to economic diversification and employment (Ayyagari, 2007). Since banks are not able to control all actions of borrowers due to imperfect and costly information, they formulate the terms of the loan contracts in such a way as to reduce the risks associated with borrowing. More recently, in 2019, the National Bank of Ethiopia passed a directive to establish a Credit Reference Bureau system in 2019 (See: “Establishment and Operation of Credit Reference Bureau Directives No. CRB 02/19.”) This should help to lay the groundwork for information aggregation and a more systematic and synthesized ability to underwrite SME credit requests

Alternatively, a good lender-borrower relationship is acknowledged to overcome asymmetry of information and inadequacy of collateral issues (Ghimire & Abo, 2013). When there is imperfect information, which is recurrent in most SMEs cases particularly in developing countries, a lender-borrower relationship becomes the main source of information and vital for loan approval. (Mills, Bonner, & Francis, 2006) show a positive correlation between a good lender-borrower relationship and the approval of a loan. Preferences will be given to firms which have established a strong and durable relationship with their banks and abide by all previous contractual arrangements.

Ethiopia undertook a banking reform program in 1994, three years after the centrally planned economy was formally reoriented more towards a market-focused approach. Unfortunately, not much has changed vis-à-vis the country’s SMEs because they are the key category that has borne the brunt of the “missing middle.”

Those who are involved in the importation of partially finished goods (e.g. Fosera) for local assembly report that their biggest bottleneck challenges are access to foreign exchange in order to pay for their imports.⁵ This same concern was echoed during other in-person interviews, e.g. Ethiopia Resource Group (ERG) who are also operators of one of only two licensed mini-grids in Ethiopia⁶.

The “Missing Middle”

This phrase refers to the unique situation where MFI and rural collective schemes (RUSARCOs) focus more on the micro-scale borrowers, while commercial banks tend to focus on larger companies with bigger borrowing needs. In such a scenario, the SME is left in the uncomfortable middle without adequate access to credit financing.

Interview results revealed that banks and MFIs serious engagement in financing SMEs in Ethiopia is limited. The demand of access to finance is significantly influenced by factors such as the firm’s prior interaction with banks and the bank’s knowledge about the borrowing entity. In a similar fashion, SMEs specific factors such as poor financial records, lack of adequate collateral, poor back-office management are the major obstacles underlined by banks and MFIs to their engagement with SMEs.

⁴ Ministry of Irrigation Water and Energy – Power Sector Reform Roadmap January 2020.

⁵ Thomas Koepke, Fosera Ethiopia, in-person meeting, Addis Ababa, 22/10/2020

⁶ In-person interview with Co-founder of ERG, 29/10/2020

4.2 Financial Institutions

The role that financial institutions play in an economy is significant. It is the bridge between the providers and users of credit that drives growth, employment, and other socio-economic and development activity.

In Ethiopia, the sector is populated by

- **Commercial Banks** - Focus on Large Clients
- **Microfinance Institutions (MFIs)** - Focus on microfinance level clients
- **Rural rotating investment clubs (Ekubs / RUSARCOS)** - Focus on micro-finance level clients

Commercial banks in Ethiopia are often small and undercapitalised, except for the Commercial Bank of Ethiopia, which owns most of the national assets. Left adequately unattended are the SMEs, on a phenomenon referred to as the “missing middle”(more details in section [4.1](#)). The micro-lenders consider them too large, and the commercial banks consider them too small. The big divider, however, as described overwhelmingly during the in-person interview process revolves around collateral requirements. (more details in section [0](#)).

Ethiopia has conducted financial sector reform following the change in government and economic policy in 1991. (Yimer, 2011) as follows



The absence of formal securities market and private pensions in the country, have also made the country lack dependable domestic long-term finance. The payments system of the country has also remained largely to be based on the cash mode of payment. The country needs to improve on all these. Ethiopia has not, however, achieved desirable level of banking, insurance and microfinance services. A substantial size of the Ethiopian population still lives without them.

The banks, insurers and microfinance institutions are also weak in their:

- Fixed capitals,
- Service types,
- Governance and
- Competitiveness.

They have not diversified, modernized, automated and networked their services. The banks, other than the Development Bank of Ethiopia, also concentrate on short- and medium-term trade finance while the insurers concentrate on short term general insurance making the total long-term insurance less than six percent of the total insurance business in the country. The microfinance institutions also concentrate on short-term deposit taking and lending with very small section of the society despite their extensive authorization to stimulate the development of micro and small-scale operations(More details in section:0).

4.3 The Role of Fintech

The National Bank of Ethiopia (NBE) has issued the long-awaited directive that will regulate payment instruments issuers which includes mobile money, wallet and similar digital financial services in Ethiopia. The new directive titled "Licensing and Authorization of Payment Instrument Issuer Directive No. ONPS/01/2020" is poised to replace the previous Mobile and agent banking directive that paved the way for the likes of M-Birr, Hello-Cash, CBE-Birr, Amole, and other mobile money services to flourish.

The 2012 directive had allowed banks and microfinance to provide mobile money service via agents. With that, customers were able to sign up at an agent or branch location and be able to transact up to 6,000 ETB daily and have a maximum account balance of 25,000 ETB. In addition, Banks and MFIs could partner with technology service providers through either software acquisition or revenue sharing arrangements. (<https://allafrica.com/stories/202004140612.html>, accessed 01/11/2020).

► **This new directive paves way for the creation of a new type of financial service providers beyond the usual banks and microfinance. It introduces Fintech's or also referred to by the national bank of Ethiopia as "Digital financial service providers" or DFS providers in short.**

This arrangement is taken from other countries' experiences such as Nigeria where financial technology companies (Fintech) are licensed by the regulator to provide a limited range of financial services. This move is partly attributed to the low performance of banks and microfinance in delivering their promise of financial inclusion and eased digital payments using mobile.

Banks and microfinance in Ethiopia have rolled out a total of 18 mobile money services via partnerships with fin-techs or directly acquiring the technology and rolling out on their own. So far, Banks and MFI's are not able to succeed as the likes of M-Pesa did in Kenya. All mobile money platforms in Ethiopia acquired a total of around 8 million customers to date, around 20,000 agents. Their set of services are also limited to sending money and a handful of payments. However, one could argue it will not be fair to compare the success of a telecom led mobile money like M-pesa against banks led mode mobile money platforms and point that both are operating in a different context.

4.4 Improved Cookstoves

According to the in-person interviews, it was understood that the Improved Cookstoves (ICS) sector did not receive much user demand from its intended targets, primarily the rural population. According to a report by the World Health Organization, "*Opportunities for Transition to Clean Household Energy in Ethiopia, (2018)*," over 95% of households continue to rely on biomass for their daily cooking, at great disservice to their health and the environment.

► **This sector at the rural level had more or less been abandoned by the local players due to its low uptake with the local population. It was described as a sector that is heavily reliant on donor grant funding and has not proven to be independently viable in the market.**

- ▶ **The government is still keen to support the uptake of efficient cookstoves for the urban and per-urban areas for a variety of reasons. The key reason for this position is that cookstoves are one of the single largest users of biomass, especially woody biomass, due to their use for making injera, the national dish in Ethiopia. It is hoped that a switch to either electric or ethanol fuelled injera cookstoves would be instrumental in reducing GHG emissions and also contribute towards deforestation efforts.**

4.5 Mini-grids

A paper published by the Stockholm Environment Institute, entitled “Mainstreaming Sustainable Energy Access into National Development Planning: The Case of Ethiopia,” highlights the progress Ethiopia has made in recent years in expanding energy access, but the country’s experience also shows the many challenges in providing sustainable energy for all. (Zereay, 2013)

Even though the government has recognized the importance of energy access in rural areas the efforts to enhance access have focused primarily on grid extension. Off-grid options have been slow to take hold due to limited funding, lack of private-sector engagement, and a lack of government leadership and institutional capacity. The National Electrification Plan (NEP) grid program currently envisaged the achievement of 65 percent of on-grid connectivity at least cost by 2025, and of 96 percent by 2030, and is supportive of mini-grid development.

The In-person interviews revealed that:

- ▶ **More support should be provided to mini-grids all-across the sector, including capacity building at the Ministry of Water, Irrigation and Electricity of Ethiopia (MoWIE), the financial institutions, and private operators.**
- ▶ **We further learned that DBE never received any loan request by mini-grid operators during the period of the WB/DBE credit facility. This is particularly concerning given the national targets to electrify all off-grid areas by 2025.**

Taken together, an emerging set of outcomes, i.e. challenges or hinderances, begin to crystallize and lead to a deeper understanding of the bottlenecks to financing access for SMEs and especially in rural areas. The deeper understanding leads to the formulation of a set of recommendations that could provide much needed intervention and bridge the gap that is commonly known and referred to as the missing-middle in the Ethiopian financial sector.

5 STAKEHOLDER OVERVIEW

5.1 SMALL AND MEDIUM ENTERPRISES

There exists a handful of SMEs active in the energy space in Ethiopia, which are for the quasi-totality national. Two international assemblers and whole-sellers of solar kits operate in the country, and some foreign investors are timidly entering the sector of mini-grids following recent changes, of expected trends, in the regulatory framework applicable to the sector; there's little movement in the cooking sector, and almost nothing happening in the energy efficiency sector.

There is a widespread common understanding in the sector that if the Government is to achieve its ambitious goals in terms of national electrification and energy access, further reforms are necessary to allow capitals to flow in the country.

The informal economy of the “mercato” market of Addis Ababa

It is estimated by the interviewees that the “mercato” informal economy of low-quality, illegally imported (solar kits) or locally manufactured (cookstoves) products accounts for up to 80-90% of the sector.

The value propositions of such products are i) extremely low prices and ii) highly organized distribution chain capable to reach the deepest areas of the country.

Mini grids

The mini-grid sector is poorly developed in the country. And At the time this assessment was written, the Ethiopian Energy Authority (EEA) did not have any request for mini-grid licensing under processing.

It is commonly understood that the sector is waiting for the ratification of the new mini-grid directive which is expected that such directive will become effective as of late 2020 - Q1 2021, the directive should regulate the sector and boost confidence of private investors.

Besides some past and on-going efforts to promote cooperative-run mini-grids promoted by GIZ-EnDev⁷, few donor-funded pilot projects and an ongoing project for EEU-run mini-grids⁸, only 2 private companies have been licensed so far in the country.

Private Mini Grid companies	Brief Detail	Website
 Ethio Resource Group	Ethio Resources Group (ERG) is a recipient of the Off-Grid Energy Challenge, led by USADF in partnership with Power Africa, USAID and General Electric, which invests in energy entrepreneurs to reach communities not served by existing power grids.	ergethio.com
 RENSYS	Rensys Engineering & Trading, a USADF grantee in Ethiopia, successfully commissioned the country's first private solar-powered mini-grid on the island of Dek in the middle of a lake in the northern part of the country and receives license #00002.	Rensys Engineering Clean Energy for Ethiopia

At the time of the assessment the team found that there are three ongoing initiatives, in collaboration with the private sector, aiming at electrifying some refugee camps in the country, that are taking shape. These are promoted by GIZ-ESDS, NRC-EmPower, and SHELL-Mercy Corps. It is estimated that these will be among the next promising projects to be deployed in the country and whose exploitation will be carried out by SMEs.

⁷ Between 2013 and 2016, EnDev has implemented five micro-hydropower (MHP) mini-grids: four in SNNPR and one in Oromia; in 2020, GIZ EnDev is promoting the development of up to 10 new mini-grids in Amhara, Oromia, Tigray and SNNPR, also to be then operated by cooperatives.

⁸ The EEU, on AfDB financing, is deploying several PV-solar mini-grids across the country. The first lot, whose EPC phase will terminate soon, consists of 5 solar PV mini-grids ranging between 100 and 150 kWp each, for a project total value of 2,5 mio USD.

Mini-grids are open to international investors, hence allowing foreign investments to flow into the country. Yet, the country has not yet taken off in Ethiopia, and this mostly for the following reasons:

- **Uncertainty concerning the regulatory framework:** the off-grid space has not yet properly regulated in Ethiopia, with a high level of uncertainty related to licensing, exclusivity, and tariff setting. The new mini-grid tariff due end of 2020-beginning of 2021 should address all these major aspects.
- **Indirect competition with low national tariffs:** while it is expected that mini-grid tariffs shall be cost-reflective, indirect competition with national tariffs, among the lowest in the world, make social acceptance difficult to achieve.
- **Non-disclosure of electrification expansion plans by the national utility:** the national utility EEU/EEP does not make available to the public its electrification expansion plans, making it difficult for private developers to select suitable sites for their projects.
- **High inflation of Birr:** especially in the case of foreign investments, the inflation of the Birr is a major problem when it comes to expected returns on investments in USD or EUR, as tariffs are paid in local currency. To compensate for inflation, a strong escalation of tariffs is needed on yearly basis.
- **Challenges related to repatriation of profits:** Repatriation of profits, especially when these are in Birr and need to be converted in USD or EUR, currently takes between 18-24 months to be approved by the National Bank, with all negative consequences in terms of inflation over time.

Solar Kits

Only a handful of small national companies are currently active in the Ethiopian solar kits' space, despite the enormous potential of the sector. The following reasons can be mentioned for this issue:

- **Almost all operators are national:** Import, wholesale and retail trade, with the exclusion of electric commerce and locally manufactured products, are reserved to domestic investors only⁹
- **All operators are small:**
 - Banking, insurance and microfinance businesses are reserved to domestic investors only³.
 - With the exception of diaspora citizens, foreign nationals of Ethiopian origin and businesses with export licences, companies are not allowed to hold bank accounts in FOREX, and letters of credit submitted to the National Bank to access to FOREX for import purposes, average at 18 months to be processed, and often for amounts that do not exceed few thousands USD, depending on national availability.

Market entry for international players through assembly and manufacturing

National assembly and manufacturing are open to foreign investments and include the possibility to wholesale of own products. FOSERA[®] since 2012, and Hellosolar[®] (Omnivoltaic[®] products) since recently, are two international players that took advantage from such opportunity to enter the national market, through the intermediation of national retailers. Whilst the companies pursue different business strategies, they both share challenges related to access to FOREX and customs regulations.

⁹ Article 4 of Regulation No. 474/2020

As a result of the two factors above:

- International players cannot engage in the sector, with one exception (see box), either directly through equity contribution or indirectly through loans or other financial mechanisms in support of local companies.
- National players cannot access to foreign financing to scale up operations, neither in form of loans, nor FOREX for regular imports. At the same time, national institutions are poorly capitalized (apart from the Commercial Bank of Ethiopia) and limited in their capacity.

The consequence of such context is that national companies in the solar kits' sector i) are often under-capitalized, ii) cannot ensure continuity of stock and therefore operations, iii) depend on financial institutions such as MFIs to provide small recurrent loans, either directly to them or via end-consumer financing, and iv) depend on erratic donors-initiatives to provide them this reliable and constant access to FOREX.

On electronic commerce

Consistent with previous policies, the New Regulation limits wholesale trade to domestic investors except wholesale of petroleum and petroleum products and wholesale of own products manufactured in Ethiopia. Further, Article 4 of the New Regulation expands the exception to permit foreign investors to engage in wholesale trade that is carried via electronic commerce. The New Regulation does not provide a definition of electronic commerce and the qualifications required to benefit from such exception. It is expected, however, that new international players will tap soon on such new opportunity.

Similar to mini grids, the market for legally imported solar kits in Ethiopia is among the smallest in the Region. The following reasons apply:

- **Preclusion of retail to foreign investors¹⁰:** Retail is precluded to foreign investors, limiting the sector to national operators. Wholesale of own products is only allowed in case of manufacturing in Ethiopia, which is the case for two international players
- **Difficulties to access to FOREX for imports:** FOREX is extremely scarce in the country, and the situation has deteriorated since the pandemic of COVID-19, with exports plummeting. The current waiting time to access few thousands of USD from the National Bank is between 18-24 months.
- **Non-conducive market environment for PAYGO on company financing:** the fiscal regime is not conducive for PAYGO on company financing. For any sale, companies need to pay income taxes and VAT upfront, instead than based on their payment schedule, which brings additional financial stress to operations.

Energy Efficiency

Energy efficiency is a very immature and underdeveloped sector in Ethiopia. The main reason being, electricity tariffs are among the lowest in the world, both for domestic and commercial/industrial uses, making energy efficiency of limited interest in the sector. Yet, it is believed that Energy Service Companies (ESCOs) could make a difference, especially in industrial parks where power supply from the utility is erratic, and most companies often back production through own diesel generators.

ESCOs are regulated by the current legislation and subjected to licensing by the EEA (licenses to be renewed every 2 years). They are defined as companies that deliver energy efficiency improvement services with

¹⁰ With the only exception of newly opened e-commerce. Untested

respect to a customer facility or premises and accepts payment for the service based on the achievement of energy efficiency improvement. Further, ESCOs have the ability to provide the same or higher level of products or services at lower energy consumption. Energy efficiency service may constitute activities of investigation, consulting, assessing, designing, constructing, installation, rehabilitation, maintenance, management and monitoring of machinery, facilities, buildings, resulting in the reduction of energy consumption while retaining or increasing the energy service.

▶ **Despite the manifested interest of the EEA in testing such model, not a single request for licensing has been filed until today, leaving the sector largely unexplored.**

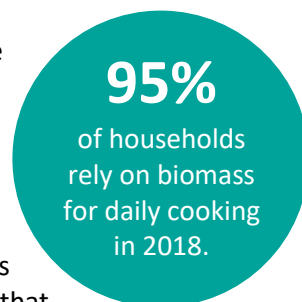
The energy efficiency sector is almost non-existing in the country, and this for the following reasons:

- **Extremely low electricity prices:** any market-driven initiative in the sector, is still unlikely able to compete with the extremely low prices of electricity applicable in the country, especially in commercial and industrial sectors.
- **High inflation of Birr:** especially in the case of foreign investments, the inflation of the Birr is a major problem when it comes to expected returns on investments in USD or EUR, as tariffs are paid in local currency. To compensate for inflation, a strong escalation of tariffs is needed on yearly basis.
- **Challenges related to repatriation of profits:** Repatriation of profits, especially when these are in Birr and need to be converted in USD or EUR, currently takes between 18-24 months to be approved by the National Bank, with all negative consequences in terms of inflation over time.

Improved and modern cooking solution

The cooking sector in Ethiopia has not really experienced much of a change over the last three decades. Despite consistent and continuous efforts by various Ministries, GIZ/EnDev, and RVO/SNV, the choice of these players to mostly target small rural artisans and consumers, has not delivered the expected results.

It is estimated that some more than 1,000 of such small-scale artisans established by different stakeholders in the country, most of them producing less than 100 stoves per year, with production that is often disrupted over the year also due to the fact that most of these artisans also have other business activities (agriculture, commerce, other) on the side. Only a handful of them reached scale.



The « mercato » cookstoves and traditional injera stoves

At the moment, only few semi-industrial manufacturers of cookstoves (such as Lakech, Obama, Tikikil) exist in the country. These include some manufacturers at *mercato*, which can rely on very cheap labour (one worker can produce as much as 20 cookstoves a day), and whose production is distributed all across the country with trucks, making them the largest manufacturers in the country.

However, traditional injera stoves remain manufactured mostly at artisanal level using mould and concrete mortar (cement and sand) at Woreda level to reach the end-users.

Yet, the market seems to be still actively looking for alternative modern solutions to traditional cooking practices, targeting especially urban and peri-urban areas, where fuel is not for free. The establishment of the Ethiopian Clean Cooking Alliance (ECCA) mid-2019 proves such dynamism.

Two major trends can be observed:



Ethanol-based cooking

- The sector bet on such technology, on the expectation of a high domestic production of bioethanol as by-product of the nascent sugar industry in the country. Years of delay in the start-up of the sugar production industry and excessively low prices for fuel ethanol (99% purity) imposed by the government, however, hindered the development of the sector. It is hoped that the sector will take off in the coming years, providing a cheaper and safer alternative to LPG cooking, and potentially charcoal.



Efficient electric injera cookers

- Ethiopia provides a quite unique market linked to electric injera cookers (mitad) in urban and peri-urban areas, which are believed to be the single most-consuming appliances in the country. As this technology has largely remained unchanged since the early 70ies, there is now scope for performance improvement and reduction of consumptions through the promotion of new efficient models. As this is believed to have tremendous positive impacts in terms of reduction on the national utility power load, such measure is being endorsed by the Government, which is trying to enforce new performance standards.

Whilst these two market opportunities might indeed provide interesting scope for sector growth in the medium-term, but due to different obstacles the sector unfortunately is not growing:

Challenges of the ICS sector



Low prices and unreliability of supply for some modern fuels, such as electricity and ethanol¹¹, provides additional uncertainty and hinders any investment in improved technologies. With electricity remaining very cheap in the country, and ethanol availability being erratic, it is difficult for producers to invest in improved technologies that might not be able to operate.



There is a low-market elasticity in the willingness to pay a premium price for higher quality products. Like in most countries, final users, especially in rural areas, seem very reticent to pay a premium price for higher quality products, especially given the low prices of most fuels available on the market.



Very low margins, hindering the opportunities for investments and innovation. Due to the low margins, the sector is dominated by the use of high-intensive extremely cheap labour, which is still more affordable than any sort of mechanization. Also, most manufacturers cannot afford any investment. The financial sector, including banks and MFIs, seem to have limited understanding of the market potential, and show limited interest due to perceived low margins.



Most companies active in the sector are for the most part artisans with very low financial literacy to set-up financing requests and mobilize collaterals to back loans. The sector has very limited financial literacy and very few collaterals, which limits their capacity to access commercial financing.



With electricity remaining very cheap in the country, and ethanol availability being erratic, it is difficult for producers to invest in improved technologies that might not be able to operate on electricity.



The financial sector seems to have little understanding and willingness to support the sector, as it sees limited potential. For example, not one request of support to the DBE/WB facility was approved in the sector.

AS A RESULT, NOT A SINGLE INDUSTRIAL MANUFACTURER EXISTS IN THE COUNTRY

¹¹ **The ethanol market in Ethiopia:** Over the last few years, the market bet on bioethanol from sugar molasse for cooking, especially in urban areas. The fuel would be produced domestically, and it is deemed safe by final users (which is not the case for LPG, for example). However, delays in the set-up of the national sugar industry, and a capped price of 11 ETB/liter on power alcohol (99,9% purity) imposed by the Government eight years ago, has hindered its production. Only technical alcohol (97%) is currently being produced on low quantities, and retailed at factory prices of 25 ETB/liter

The ethanol market in Ethiopia

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5.2 FINANCIAL INSTITUTIONS

Commercial Banks

As discussed in the literature review section, commercial banks in Ethiopia are heavily regulated and centralized under the aegis of the state-owned National Bank of Ethiopia, And with an over-representation in Addis Ababa, which leaves a big part of the country for the most part under-served.

As all commercial banks are national, with no possibility to finance themselves internationally, Ethiopian banks are in general small in size with limited financing capability, including a serious shortage of supply of FOREX available for their customers because the national bank owns most of the national assets. Financing is only possibly through national sources, which also limits their access to Forex



Loans collaterals from Commercial Banks for SMEs range between **100-130%**

Most commercial banks ask for collateral in the range 100% to 130% of the loan amounts. and the same concept goes for the loans collateral for SMEs as it ranges between 100 and 130%, making access to financing relatively difficult for the sector. Also, it was found during the interviews, that a very poor due diligence process for creditworthiness assessment was carried out by bank, privileging asset-based loans rather than project-based financing like going through a thorough due diligence process and provide financing based on business models and projected cash flows. For these reasons, SMEs are often reluctant to engage with commercial banks.

► **The reasoning for the high collateral is as a hedge against the information gap of the bank to the nature of the client and the business model, and to protect against inadequate in-house credit analysis capacity.**

Microfinance institutions (MFIs), SACCOs and ROSCAs

Ethiopia provides a quite unique network of financial institutions, both formal and informal, mostly targeting small scale enterprises and final users.

Micro-finance institutions

Micro-finance institutions are extremely well established in Ethiopia, covering the quasi-totality of the country. There are 35 MFIs in the country, of which 7 large ones that are Government owned (almost one per region), and several small private ones.

Especially with regards to the Government-owned MFIs, these have historically been supported by the state and the National Bank as vehicles of financing and development initiatives in the rural areas of the country. As a result, these MFIs are often very state-centred and bureaucratic. Also, several years of Government financing resulted in some of these institutions now only focusing on larger ventures, hence moving a bit away from their original mandate to support SMEs, as well as being heavily capitalized to the extent that some of them are now converting in commercial banks.

On the other side, several private MFIs are being increasingly acknowledged as preferred partners by SMEs active in the energy sector, due to their increased flexibility and dynamism when compared to Government-owned MFIs. On the other hand, these MFIs can only finance themselves through the savings of their clients, with limited to no support from the central government, making them small in size and financial capability.

The role of MFIs in the distribution chain of solar products in rural areas

MFIs remain the preferred partners of solar kits' distributors in rural areas, due to: i) their existing high penetration and customers relation in rural areas; ii) their relatively low default rate on payment collection (around 4%, compared to 20%+ of those companies that tested PAYGO on their own funding); iii) their experience in providing end-users financing.

However, more and more distributors are now exploring ways to bypass MFIs to reduce end-user prices.

ROSCA and SACCO

As MFIs in Ethiopia have started shifting away from MSMEs privileging larger loans, rotating savings-and-credit associations (ROSCA) and saving and credit cooperatives (SACCO) have started filling the "missing middle", especially in the micro and small range. These two mechanisms can be found both in urban, and most important, rural areas, especially in areas not served by MFIs.



Both ROSCAs and SACCOs rely on trust and reputation among members, which allows them to reduce requirements in interest rates and collaterals, as well as transactional costs. On the other hand, these mechanisms are often undercapitalized, only relying on the savings of its members, and in strong need of capacity building.

Rotating Savings-and-credit associations (ROSCA)

Rotating Savings-and-credit associations (ROSCA), also known in Ethiopia as *ekub*, allow members to access to credit through a mechanism that pools contributions from members each week and disburses the pot to the winner of a lottery, with each member winning once over the scheme's term.

Compared to other developing countries in which ROSCAs are often assumed to serve the poor, in Ethiopia these mechanisms are used across the income scale. Some have hundreds of members, with officers who vey applicants and analyse risks. One recent Assessment found ROSCA to be the most common source of external funding for manufacturing firms in Addis Ababa, Ethiopia's capital. Another found that more than two-thirds of small and medium-sized enterprises used these credits between 2002 and 2010.

The ekub mechanism is informal, not regulated by law.

Part of their success lies in the trust between members, who tend to be from the same neighbourhood, workplace or ethnicity.

- ▶ **Since many small businesses have patchy records and no credit rating, Ethiopian banks demand interest rates of up to 20% and physical collateral of up to three times the value of the loan. Most ekubs, by contrast, require only a character testimony. Even so, default is rare.**
- ▶ **A big issue is that ROSCAs are no substitute for formal financial institutions, since members cannot predict when they will be the winner and get a pay-out.**

MFIs and RUSACCOs represent the backbone of rural financing in Ethiopia. Given their capillarity across the country, SMEs collaborate with them at three levels:

Financing of sales	Distribution of product	End-user financing
Distributors often whole sell products directly to MFIs, which become then their intermediary.	MFIs and RUSACCOs often also take care of the distribution chain through their network of clients. This, however, it has been found to be critical as most of these institutions do not necessarily provide a quality service, especially in the after-sale phase, and this might have negative consequences in the long-term concerning the reputation of products and distributors.	MFIs and RUSACCOs provide end-user financing to allow their customers to pay products in instalments, usually over 6-12 months depending on the products.

On the guarantee requested to distributors

A typical practice in the sector, is that MFIs usually retain between 5 and 10% of sales of the distributors for a period of 2 years, to ensure that that distributors can provide after-sale services for their products. The amount is then paid back to the distributor after such period.

Saving and Credit Cooperatives (SACCO)

Saving and Credit Cooperatives (SACCO) are similar to ROSCA, with the advantage of being legally recognized and provide a more structured approach to the sector.

Compared to MFIs, SACCOs offer on average lower interest rates and require less collaterals, leveraging on trust and reputation, similarly to ROSCAs. Another similarity, is that SACCO only rely on the savings of its members, making them poorly capitalized.

Estimated around
18,000
SACCOs exist in Ethiopia.

There are two types of SACCOs in Ethiopia:	
RuSACCOs (Rural)	UrSACCOs (Urban)
Mostly focused on savings accounts and loans	Also providing additional services, including third-party employment

Capital goods leasing

Capital goods leasing is available in Ethiopia as a way to create an enabling environment for the establishment of alternative sources of financing for investors who have the desire, knowledge and profession to participate in various investment activities but could not act due to lack of capital.

Lessors of capital goods are assumed to fill a gap that is not addressed by the existing financial institutions.

- ▶ **Capital goods leasing is the only financial activity open to foreign investors.**
- ▶ **To date, Ethio Lease from the USA, is Ethiopia's first and only foreign-owned company with a license from NBE to operate in the Financial Services Sector.**

Mobile money providers

Mobile money is a nascent sector in Ethiopia, and national uptake is very low. One of the reasons of such delay compared to other countries in the region, is that **the sector is precluded to non-financial institutions, while in the neighbouring countries, telco companies directly operate in the sector.**

The main reason being the preclusion for players to host customers' accounts. While a new regulation seems to be opening to such option, this remains **limited to domestic investors**, only.

As such, all the few mobile-money operators currently working in the sector need to **host their subscribers' funds in accounts held by partners financial institutions, mostly MFIs and commercial banks.** Therefore, mobile money providers should rather be seen as IT platforms operating on cellular networks acting as service and transactional facilitator at the interface between financial institutions and final users.

At the moment, **only few distributors** make use of such platforms to **promote PAYGO products** on their own financing, preferring MFIs as traditional channels. For that reason, companies such as M-BIRR¹² are focusing more on supporting MFIs to improve their collection system through their services, rather than focusing on final users.

Seven

solar distributors offer PAYGO and collaborate with M-BIRR, using ANGAZA and MOBISOL platforms.

- ▶ **Recently the Government of Ethiopia has announced the opening of the mobile money sector also to non-financial institutions, which might drive strong sector developments in the near future.**

¹² M-BIRR is the first mobile and agent banking service established in Ethiopia. MBIRR works with 6 MFIs partners, for which it hosts non-interest- and interest-bearing accounts. At the moment, 7 solar distributors offer PAYGO and collaborate with M-BIRR. While integration was not as immediate as with AZURI, M-BIRR is now fully compatible with these distributors. M-BIRR also collaborates with MFIs and RUSACCOs to implement its digital services also in rural areas.

New outbreaking sector changes that are expected to take in the coming months, include:



- ▶ **The NEB starts offering a mobile money service: it is believed that as soon as the NEB will start rolling out at scale such product, given its financial capacity and government backing, the market will expand very quick.**
- ▶ **Ethio telecom start offering a mobile-money service: similar to the above, Ethio telecom is thought to start benefitting from the new sector regulation that would allow them to host accounts on behalf of their customers. Given its positioning of market monopoly, Ethio telecom will quickly become a key player. Ethio telecom just received approval from the National Bank to start piloting such model.**

Public institutions

In general terms, the energy sector, like all other national sectors in which private sector plays a role, is heavily regulated. Key players include the Ethiopian Energy Authority (EEA), various Ministries, the Ethiopian Investment Commission (EIC), the Regional Energy Bureaus, etc.

As the market evolves quickly and more foreign investments and initiatives enter the country, a general need for capacity strengthening and support is needed.

Donors’ initiatives (in support of commercial banks and MFIs)

Few donors’ initiatives have been supporting over the last years, but neither of them with a structural long-term approach. With only few exceptions, such as Africa Enterprise Challenge Fund (AECF) that provided a 5 million USD grant to companies active in the energy sector, all other major initiatives and funds have been channelled and managed through the Ethiopian Development Bank (EDB). These include:

Fund	Donor	
Rural Electrification fund 2005 (until 2024)	MoWIE	The fund started supporting GenSet based mini-grids, to then open up to solar home systems (SHS). To date, the programme has impacted 40,000 households connected with SHS, by providing financing to 696 cooperatives.
Forex credit line	World Bank <i>40.0m USD, disbursed in two phases</i> <i>*More about the World Bank initiative in the info box below.</i>	As all funds have already been allocated, a new phase is now under appraisal. The difference between the first and the second phase is that the first phase required high collaterals, which only nine importers were able to raise; in the second phase, a 4.5 m USD collateral support facility was put in place and DBE used Bankers Association asset valuation manual rather its own, allowing more companies to access to credit. 32 enterprises benefitted from the facility. Also, repayments in ETB from importers were then used to finance MFIs, that could either support distributors, or provide end-users’ financing. 14 MFIs have benefited from it.
Risk-credit guarantee fund	UNDP <i>1.42m USD</i>	The facility mostly targets SMEs undertaking loans from MFIs and commercial banks.
	Financed through carbon financing	Aiming at reducing the use of kerosine lamps

The Development Bank of Ethiopia-World Bank facility

The DBE-WB is widely acknowledged as the most impacting initiative in the Ethiopian off-grid energy sector to date. It provided loans in USD to importers, whose repayment in ETB was then channeled through MFIs to provide end-user financing for the purchase of solar kits (not a single mini-grid developer applied for it, and few cooking providers applied, but were not able to raise sufficient collaterals).

As above mentioned, the first fund was split in two phases of 20.0m USD each, with all funds being allocated. A new phase is currently under appraisal. The second phase mainly aimed at lowering the collaterals requirements, considered to be too high by most applicants. This was quite considered a successful move.

Main critic: Applicants could make only one loan request per programme phase, and collaterals had to be mobilized accordingly. For importers that rather prefer importing small quantities on regular basis, and therefore make request for smaller loans over time, this was considered a hefty entry ticket.

Other donors' initiatives, mostly focused on mini-grids, are coming up. These include EnDev-GIZ, the EU, Mercy Corps, the Norwegian Refugee Council, among others.

- ▶ **World Bank is now rolling-out a 400 million USD programme aimed at boosting the electrification in the country, the largest of its kind ever designed by the bank.**

Regional Energy bureaus

In each of the 10 regions in the country, regional energy bureaus are public institutions charged with ensuring compliance of energy-related activities and products as per applicable legislation. Typical activities include ensure that solar kits sold respect national standards, or that agreed tariffs between the operator and the regulator for mini-grids are respected.

- ▶ **Typically, companies willing to operate in a specific region first need to get the approval by the local bureau. Without such written approval, for instance, local MFIs are not allowed to provide financing services.**
- ▶ **One of the main criticisms of operators is that these institutions are often slow, and the lack of skills and additional level of complexity for distributors to operate in the country.**
- ▶ **As the market evolves quickly and more foreign investments and initiatives enter the country, a general need for capacity strengthening and support is needed for participating public institutions in general.**

Other commercial sources of funds

Some impact investors, such as the *Addis Ababa Angels Network* (www.addisababaangels.com) and *Renew* (renewstrategies.com/) exist on the market. However, these are rather focussed on exporters, rather than net importers, as they aim at being remunerated in hard currency, rather than in Birr.

5.3 STAKEHOLDER CHALLENGES – HEAT MAP

In order to provide a visual overview of the challenges faced by the different interviewees with regards of different categories, the following heat map was developed:

IDENTIFIED CHALLENGES HEAT MAP	SECTOR	FOREX	COLLATERAL	BUREAUCRACY	RGULATORY	AWARENESS
Green Scene	SME	3	2	2	2	1
Fosera	SME	2	1	3	3	2
Megen Power	SME	3	2	2	2	1
ACME	Mini-grid	2	3	3	3	1
ERG	Mini-grid	3	2	3	3	2
ECCA	Civil Society	1	3	2	2	3
M-Birr	Fintech	1	1	3	3	2
RENEW	MFI	2	3	2	3	2
Dashen Bank	Fin_Inst	3	3	3	3	1
DBE	Fin_Inst	3	3	2	2	3
Empower	Fin_Inst	1	1	3	3	2
Scale	1-Moderately important		Blue			
	2-Somewhat important		Brown			
	3-Very important		Red			

6 SECTOR LIMITATIONS AND OPPORTUNITIES

6.1 COVID-19

The impact on the social-economic life caused by the global COVID-19 pandemic have had a significant impact on the Ethiopian economy, and indeed, the overall African economic landscape. As an agrarian economy that is reliant on a robust export market to earn hard currency in order to support its import needs, Ethiopia has suffered significantly.

As a result of reduced exports and travel, the Birr has come under tremendous pressure to depreciate. Should the Birr depreciate, there will significant downstream ripple effects, especially to importers who are in need of FOREX, and who also risk having 70% of their forex retention accounts automatically converted to Birr if not used within 28-days.

The internal market, however, has been disrupted by the slowdown of external markets which has negatively affected diaspora remittances. As a significant source of precious hard currency, the downward trend in diaspora remittances does not bode well for the overall economy. It is expected that there will be long term alterations to the macro-level business environment for some time to come, e.g. airline travel, hotel, etc. which can affect tourism and hence have structural changes to certain economic pillars.

6.2 PAYGO

The PAYGO market sector is at an interesting inflection point in Ethiopia. On the one hand, at face value, it would seem that it is a tremendous opportunity for investment and growth. However, upon a deeper review and analysis, this confidence begins to get slippery when considered against the Government's plans in the coming years as part of the National Electrification Program, and its stated objectives of universal access for all by 2025.

Because the Government of Ethiopia is much less dependent on pure economic returns in its decision-making process, it is expected to spend heavily into achieving the universal grid access for all by 2025. This ambitious plan may only be slowed down by the continuing uncertainties brought upon by the Covid-19 pandemic, and the growing rural population.

- ▶ **Due to the expectation of the promised universal grid access, end users may be hesitant to acquire SHS systems.**
- ▶ **The payment mechanism for cost-recovery is still limited by regulation surrounding the payments collection. There is some loosening of these restrictions, such as participation of non-bank actors in this space, but restrictions still exist in barring the charging of interest for cost-recovery.**

Foreign investors are also not allowed to participate in distribution or retail, which creates market limitations and artificial market (competitive) conditions.

6.3 SECTOR LIBERALISATION

PAYGO

As previously mentioned, there is some positive development in this sector as it is set to be further opened up in various ways. One significant development is that non-bank actors will have the ability to collect payments (restrictions on interest rate charges notwithstanding).

Fintech

In the fintech sector, there is some positive movement towards having some variant of mobile money. Currently this does not exist. What exists is mobile banking, which is essentially a mobile wallet from a pre-existing account and a participating institution, such as a commercial bank (Amole mobile service & Dashen Bank; or M-Birr and its MFI partners). The current set up is banking-driven, and restrictive.

We strongly recommend a shift towards true mobile money, telco-driven. It should be noted that this liberalization is going to be realized very soon, and it will be a welcome relief and when it is complemented by respective liberalization with complimentary platforms, e.g. bill payments, PAYGO payment, financial institution independent (and untethered), etc.

Another significant change is the permission given to MFIs to become fully fledged commercial banks. This will have the positive effect of expanding their possible client reach but may come at a cost of leaving behind some of the smaller clients who may not have the ideal customer profiles to be served at traditional commercial banking institutions. However, should fintech be given true space to thrive and flourish, then this particular development may not have much relevance to the small and medium sized enterprises in Ethiopia.

6.4 OTHERS

E-Commerce

E-commerce needs better definition as it appears to be a grey area that could provide some opportunistic manoeuvres. It may, for example, allow a foreign investor that is involved in manufacturing to enter the distribution and/or retail space by merely having an on-line shopping presence on the internet that can be accessed and shopped from by local Ethiopian end users and or retail outlets.

Forex retention accounts

It is understandable that under the current conditions of a global economic slowdown, the forex retention regulations remain too onerous. The regulations of having a 28-day window within which to utilize 70% of forex reserves for foreign investors is quite strict. It may be easier to have a graded fee scale on retention accounts that would prioritize rapid utilization, but not at the possibility of losing the funds altogether.

7 CONCLUSIONS

The results of the assessment revealed very clear hinderances and bottlenecks to the proper accessing to finance for SMEs in the energy sector in Ethiopia. It was also shown that the Government of Ethiopia is also well aware of many of the bottlenecks and is working towards addressing them, perhaps slower than preferred by many of the stakeholders that were interviewed.

Evidence of this is seen in the fact that moves are being made to either introduce new directives or rekindle and enforce previously passed directives in the financing sector and with a view to adapting the sector to the fast-changing environment of technology and credit utilization. Examples of these include freeing up space to non-bank actors to perform bank-type activities (e.g. mobile banking), allowing MFIs to register as fully-fledged banking institutions, and playing a balancing trend between the needs for forex buy importers and the dwindling government reserves due to a slowed economy and lack of an exchangeable market currency.

Vast improvements still need to be made, and it is in between these gaps where the current regulatory environment is and where it needs to go, where EnDev can seek to target its interventions so as to achieve its country-wide objectives.

8 RECOMMENDATIONS

HINDERANCE	INTERVENTION	KEY BENEFICIARY	PARTNERS
FOREX	FX Guarantee Fund	Importers (esp. SHS/PAYGO)	NBE; DBE; DONOR
	Internal FX Reserves Fund	Importers (esp. SHS/PAYGO)	NBE; DBE
COLLATERAL	Guarantee Fund	SME	NBE; DBE; DONOR
	Capacity Building	SME; Mini-grids;	DONOR
	CRB – Credit Reference Bureau	SME	NBE; DBE
	Receivables Financing	SME	
REGULATORY	Advocacy	SME; SHS; ICS; Fintech; Mini-grids	NBE; Min of Finance
BUREAUCRACY	Capacity Building	ALL	All Financial Institutions
	Technology		
	Embrace Technology		

Table 2: Table of interventions

The assessment recommendations (interventions) are described below.

Access to adequate amounts of, and in a timely basis of, foreign exchange was by far the most frequently mentioned bottleneck by the respondents to the assessment team in-person meetings and digital questionnaire. It is, however, also acknowledged that this subject is much more relevant to those companies involved in the importation of finished or semi-finished products either for onward distribution or for in-country assembly. Without adequate supplies of forex, importers are hampered in their ability to conduct smooth flowing business operations and their in-country operations can often grind to a halt as inventory dries up.

Adding to the formidable challenges of importers on this subject is the restriction on the ability of firms to retain forex in their accounts. According to existing regulations, importers of product for in-country assembly or recipients of inward remittances have 28 days within which to utilize 70% of the received amount of forex, while they retain indefinitely the remaining 30%¹³. This puts a big amount of pressure on importers (and exporters) to use up their forex reserves and forces them to act out of sync with their inventory needs. Perhaps there may be a better, more creative, mechanism that may accomplish the objective of keeping the forex in “fast-motion” as the Government would like, but also relieving some pressure from the importers. The assessment team examined this question as part of the search for a more streamlined approach.

RECOMMENDATION 1: Create a FOREX Guarantee Fund

Activity 1.1: With the assistance of the donor community, create a fund of pooled FX funds that would be utilized as a guarantee mechanism to serve the needs of importers.

Activity 1.2: Importers could make a one-off application in advance for pre-screening and provide annual financial updates to their banking institution in order to maintain continuous eligibility. They could then remain on the list of “pre-screened” importers. This would eliminate the need for continuous applications for forex, which adds to the bureaucratic bottleneck.

Activity 1.3: Determine a framework for a selection process to prioritize candidates. Currently the NBE has published a list of priority sectors for access to forex.

Activity 1.4: Register selected SME/Importers and monitor their utilization of the facility in order to determine if size limits would need to be imposed, or inversely, increased.

RECOMMENDATION 2: Develop a mechanism to utilize in-country forex reserves

Activity 2.1: In order to address the limiting constraints imposed by the NBE FX Directive on retention of forex account reserves, a way should be explored to facilitate creative utilization of in-country forex already present in importer’s accounts. What this means, in practical terms, is that if an exporter has received payment for goods or services, and has the funds in their account, they could be able to make them available to an importer who may be simultaneously in need of forex because they have a pending payment to make.

Therefore, instead of the exporter losing their forex funds due to lack of utilization within the 28-day window, they could put the funds to work for the benefit of an importer who needs quick access to forex. In this manner the importer would be equally relieved from having to wait for several months for an allocation of forex. There may be a “fee” charged by the provider of the forex to the user of the forex.

It should be noted that a variant of this mechanism is already in existence under the current regulatory framework. Foreign investors operating within the industrial parks are permitted to purchase, in forex, inputs from other foreign investors within the same or other industrial parks utilizing their forex retention accounts¹⁴.

Activity 2.2: Create a database of cross-reference of importers and exporters scheduling of “needs” and have a “matching” mechanism. This mechanism could be linked to the participating financial institutions as well as the NBE and/or DBE if deemed necessary.

¹³ National Bank of Ethiopia Directives FXD/66/2020, Article 5

¹⁴ Foreign Exchange Transactions in Industrial Parks Directive No. FXD/59/2019

RECOMMENDATION 3: Mitigate against collateral restrictions

Activity 3.1: Operationalize the Credit Reference Bureau Directive. The regulatory framework already exists in Ethiopia for a centralized Credit Reference Bureau mechanism. This is contained in the 2019 NBE Directive for the *“Establishment and Operation of Credit Reference Bureau Directives No. CRB/02/2019.”* According to Article 5 of this directive, *“no financial institution shall extend new, or renew, reschedule or refinance existing loans unless it is registered with the Credit Reference System.”* What seems to be lacking is the formal activation and utilization of this mechanism. EnDev could play a significant role in providing technical assistance intervention in order to assist in the creation of a streamlined, technology-based, platform that would link the participating financial institutions and provide a cross-referencing mechanism.

This would be a big step towards bridging the information asymmetry gap between SME borrowers and lending institutions. By having borrower information more readily available via the CRB registry, lending institutions can mitigate their risks, and thereby offer better terms to the borrowers such as lower collateral requirement and/or lower interest rates.

Activity 3.2: Create a Collateral Guarantee Fund. It was learned through our stakeholder interviews that the WB/DBE credit support facility may soon be re-introduced. This was a facility that utilized credit from the World Bank to provide loans to private sector Enterprises and Micro Finance Institutions. The main objective of the credit line was to provide access to finance to remote off-grid Renewable Energy programs.

The facility was quite successful and resulted in Introduction of new energy credit line in the country. Its increased awareness about renewable energy products, especially lighting global approved solar lanterns, increased in number of participating PSEs and MFIs, distributed of more than 500,000 solar lanterns and contributed towards GHG emission reductions by the introduction of renewable energy technology in rural areas. This was a two-phased program which ended in 2019. It is hoped that it may reappear in the same or similar format soon. EnDev could contribute towards an advocacy effort to lobby for its reintroduction or the creation of a similar facility.

Activity 3.3: Create an invoice financing mechanism. While conducting this Assessment, it was found that most SMEs (especially distributors) use a cash-based system in their inventory management practices. This is because they are unable to access credit facilities on beneficial terms via the normal channels of commercial banks or MFIs. These channels have hinderances such as collateral or high interest rates that keep them away. The result of this cash-based approach is that inventory may not move quickly enough to the downstream retailers and consequently to the final consumer end-users. This financing gap creates an opportunity for the establishment of a mechanism of “factoring” or securitization of the distributor’s receivables created when selling products to their retailers. By monetizing the receivables, distributors would have faster access to funds which can be utilized to restock inventory. The receivable would itself be the collateral in the transaction. This would also be beneficial to the upstream manufacturers who would be paid faster and utilize their funds to purchase more inputs for their own operations.

Technically, invoice factoring is not a loan. Rather, the invoice is sold at a discount to a non-bank actor, such as a factoring company, in exchange for a lump sum of cash. The factoring company then owns the invoices and gets paid when it collects from the payors, typically in 30 to 90 days. As an example, a firm makes a sale and creates an ETB10,000 invoice. The customer agrees to pay in 30 days, but the seller need the cash within a week to purchase additional inventory or to pay its employees. In this case, there is a cash shortfall. A traditional bank loan would require stellar personal credit plus collateral, such as real estate, in case of default. Or maybe the firm qualifies but can’t wait several weeks or months for the loan to close. In such a case, invoice factoring would be an acceptable solution. The key advantages are quick access to cash; no collateral; and easier approval process.

A receivables financing mechanism could be operationalized via NBE authorized bank or non-bank actors. EnDev could play a role in advocating for such a facility by engaging with the relevant stakeholders such as the NBE and DBE at the upstream levels, as well as with commercial banks and MFIs, at the downstream levels.

Activity 3.4: Revenue based financing (RBF) facility

This is an old, traditional, plain-vanilla revenue-based financing mechanism that is widely utilized by firms in fast moving inventory business models that need constant access to cash for inventory management. The concept is quite simple. A company receives an upfront investment in exchange for an on-going monthly or quarterly payment calculated based on a percent of top-line revenue until some pre-determined point in the future. The termination can be time based (e.g. 5 years from the funding date) or total return based (e.g. when cumulative payments reach 3x the initial investment amount).

In general, Revenue-Based Financing is non-dilutive to the equity holders, as it is always in the form of a loan. And even though it is a loan, most RBF providers do not require a personal guarantee unlike a typical bank loan. Instead, a company's loyal customers and high-quality revenue streams act as the collateral. It is expensive money, typically more expensive than a standard bank loan. However, it is ultimately not as expensive as having to lose business due to inability to access traditional sources of financing.

RECOMMENDATION 4: Address regulatory restraints

Activity 4.1: Lobby for the easing of burdensome constraints, such as the prohibition of non-local players from engaging in distribution and/or retail.

Activity 4.2: Lobby for the creation of true telco-driven, mobile money, and move beyond the current bank-driven mobile banking. It is noted that there are plans in the making to allow for Ethio Telecom to enter the space of mobile financial transactions. While it is yet unclear what precisely this entails, the outcome of our stakeholder interviews reveals a clear need and desire for the creation of a mobile money mechanism that would untether users from having to have accounts at formal banking institutions, and also that would allow them to transact instantaneously between each other, in a similar fashion to the very successful M-Pesa system in Kenya.

Such a mechanism would also dramatically increase the uptake of off-grid applications such as SHS/PAYGO systems and others. We are aware that the Ethiopian National Electrification Plan calls for universal grid access and achieving middle-income country status by 2025¹⁵. In actual terms, this date is a mere four-years away, the global economy is being ravaged by the COVID-19 pandemic, and the Ethiopian population continues to grow. In short, the objective, while noble, is also quite ambitious and off-grid applications, as well as mini-grid developments, could play an important role to bridge the gap until universal access is achieved. These systems (SHS, mini-grid, etc.) lend themselves perfectly for the utilization and adoption of true telco-driven mobile money platform mechanisms.

RECOMMENDATION 5: Ease process bureaucracy

Activity 5.1: Provide capacity building to loan officers to better understand SME underwriting.

Activity 5.2: Introduce SME specific departments staffed by trained specialists.

Activity 5.3: Introduce fintech in the financial lending ecosystem

¹⁵ National Electrification Program 2.0 of 2019, Integrated Planning for Universal Access

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10 ANNEXE 1: INTERVIEWEES LIST

Table 1 : Interviewee list

IN-PERSON Meeting in Addis Ababa Ethiopia				
Name	Organisation	Title	Sector	Contact
Desta Bayisa	M-Birr	Deputy CEO	Fintech	desta@mossict.com
Tebebu Solomon	Dashen Bank	Chief – Retail & MSME Officer	Financial Institution- Commercial Bank	tebebu.s@dashenbanksc.com
Hilawe Tesema	Ethiopia Resource Group (ERG)	Co-founder & Director of Projects	Mini-grids & Improved cookstoves	hilawe@ergethio.com
Thomas Koepke	FOSERA	General Manager at FOSERA Ethiopia assembly line	SHS – Assembly and wholesale	thomas.koepke@fosera.com
Rekik Bekele	Green Scene Energy	CEO	SHS – Distribution & Retail	info@greensceneethiopia.com
Melessaw Shanko	Megen Power	CEO	Energy Consulting & SHS - Retail	melessaw.shanko@gmail.com
Konjit NEGUSSU	Ethiopia Clean Cooking Alliance (ECCA)	Director	Civil society	konjitn@gmail.com
RESPONSE TO ON-LINE QUESTIONNAIRE				
Loza	Acme Engineering and Trading Plc	Marketing and Business Development Head	SHS – Distribution & Retail	info@acme-et.com
Laura Davis	RENEW	Managing Partner	Impact investor - Fund	ldavis@renewstrategies.com
Ørjan Alexander Pedersen	Empower New Energy	COO	Impact Investor in mini-grids - Fund	alexander@empowernewenergy.com
RESPONSE VIA TELEPHONE, EMAIL AND/OR VIDEO PLATFORM				
Elias ASNAKE	Development Bank of Ethiopia (DBE)	Directorate Energy Coordination - Team Manager	Financial Institution – Development Bank	eloasn@hotmail.com

11 ANNEXE 2: QUESTIONNAIRES

Questionnaire for SMEs

Mapping of the different actors & interventions

1-Which are the top or best-known financial institutions, initiatives and programs supporting SMEs in the energy sector in Ethiopia, and what do they usually offer?

For example: financial institutions can include commercial banks, micro-finance institutions, private investors, donor-based initiatives offers can include loans, equity, grants.

2-Are these financial institutions well represented in the different provinces? Or are they cantered mostly in the big city centres, like Addis or Mekelle? If cantered in the cities, who serves the rural areas?

Currently available financing to SMEs in the energy sector

3-Do you feel that there are enough financing programs available to SMEs in the energy sector from financial institutions and initiatives in Ethiopia? If not, why?

For example: lack of interest by donors; complex market regulation; lack of national interest in the sector and relative policies and strategies.

4-Do you believe that the sector provides promising outlooks in term of market development and opportunities?

5-Do you think that more financing programs and initiatives to SMEs in the energy sector should be promoted? How would you estimate the current interest and demand of such services – strong, medium, low?

6-Can such demand be improved? If yes, how?

For example: a better marketing and outreach strategy by the banks; easier terms and conditions on the loans such as lower interest or more flexible collateral conditions; more accommodating legislation.

Hinderances and bottlenecks of financing to SMEs in the energy sector

7-List the top three challenges that you see in the availability of financing for SMEs in the energy sector. *For example: financial institutions ask for too much collateral that many SMEs do not have; financial institutions do not have a good understanding of the sector so therefore they do not have knowledgeable lending staff; financial institutions perceive the sector or SME lending to be risky and they are more assured of better returns to focus on larger companies.*

8-Have you or any other SMEs you know about faced specific difficulties in accessing financing that were caused by the bottlenecks discussed above? If yes, which ones?

9-How do you think that the financial institutions can begin to address these bottlenecks and overcome the challenges? What steps can they make?

For example: provide better training to their staff (capacity building) on how to understand and analyse SME credit risk; adopt better outreach efforts to target SMEs in the energy sector; collaborate with bilateral and multilateral agencies to solicit for funding in order to provide on-lending to local SMEs

10-If you had the opportunity to make some recommendations, how would you propose to make financing more easily available to SMEs in the energy sector?

Give three recommendations. These can include recommendations concerning the regulatory environment, and the need for capacity building.

Questionnaire for Financial Institutions

Mapping of the different actors & interventions

1-Do you know of any SMEs active in the energy sector in Ethiopia, and what do they offer?

For example: mini-grid operators, solar kits distributors, ESCO companies, etc.

2-Are you aware of any government or donor-backed initiative active in the energy sector in support of the SMEs and/or financial institutions?

For example: concessional credit lines, financial guarantees, technical assistance for the set-up and assessment of business model

Currently available financing to SMEs in the energy sector

3-Do you feel that there are enough financing programs available to SMEs in the energy sector from financial institutions and initiatives in Ethiopia? If not, why?

For example: lack of interest by donors; complex market regulation; lack of national interest in the sector and relative policies and strategies.

4-Do you believe that the sector provides promising outlooks in term of market development and opportunities?

5-Do you think that more financing programs and initiatives to SMEs in the energy sector should be promoted? How would you estimate the current interest and demand of such services – strong, medium, low?

6-Can such demand be improved? If yes, how?

For example: a better support to SMEs; provision of additional collaterals; more accommodating legislation.

Hinderances and bottlenecks of financing to SMEs in the energy sector

7-List the top three challenges that you see in the availability of financing for SMEs in the energy sector. *For example: SMEs don't provide enough collaterals; SMEs do not have a good understanding of the sector so therefore they do not propose solid business plans; SMEs perceive external financing to be risky and they rely on other informal lending channels*

8-Have you or any other financing institution you know about faced specific difficulties in supporting SMEs that were caused by the bottlenecks discussed above? If yes, which ones?

9-How do you think that the SMEs can begin to address these bottlenecks and overcome the challenges? What steps can they make?

For example: provide better training to their staff (capacity building) on how to understand and analyse financing options; adopt better outreach efforts to target financing institutions and initiatives in the energy sector; collaborate with bilateral and multilateral agencies to solicit for funding

10-If you had the opportunity to make some recommendations, how would you propose to make financing more easily available to SMEs in the energy sector?

Give three recommendations. These can include recommendations concerning the regulatory environment, and the need for capacity building.

Questionnaire for Public Institutions

Mapping of the different actors & interventions

1-Do you know of any SMEs and/or financial institution/initiative active in the energy sector in Ethiopia, and what do they offer?

For example: SMES can include mini-grid operators, solar kits distributors, ESCO companies; financial institutions can include commercial banks, micro-finance institutions, private investors, donor-based initiatives offers can include loans, equity, grants.

2-Are you aware of any government or donor-backed initiative active in the energy sector in support of the SMEs and/or financial institutions?

For example: concessional credit lines, financial guarantees, technical assistance for the set-up and assessment of business model

Currently available financing to SMEs in the energy sector

3-Do you feel that there are enough financing programs available to SMEs in the energy sector from financial institutions and initiatives in Ethiopia? If not, why?

For example: lack of interest by donors; complex market regulation; lack of national interest in the sector and relative policies and strategies.

4-Do you believe that the sector provides promising outlooks in term of market development and opportunities?

5-Do you think that more financing programs and initiatives to SMEs in the energy sector should be promoted? How would you estimate the current interest and demand of such services – strong, medium, low?

6-Can such demand be improved? If yes, how?

For example: a better support to SMEs; provision of additional collaterals; more accommodating legislation; a better marketing and outreach strategy by the banks; easier terms and conditions on the loans such as lower interest or more flexible collateral conditions; more accommodating legislation.

Hinderances and bottlenecks of financing to SMEs in the energy sector

7-List the top three challenges that you see in the availability of financing for SMEs in the energy sector. *For example: SMEs don't provide sufficient collaterals; SMEs do not have a good understanding of the sector so therefore they do not propose solid business plans; SMEs perceive external financing to be risky and they rely on other informal lending channels; financial institutions ask for too much collateral that many SMEs do not have; financial institutions do not have a good understanding of the sector so therefore they do not have knowledgeable lending staff; financial institutions perceive the sector or SME lending to be risky and they are more assured of better returns to focus on larger companies*

8-Have you or any other national, international or multi-governmental institution you know about faced specific difficulties in supporting SMEs that were caused by the bottlenecks discussed above? If yes, which ones?

9-How do you think that the SMEs and/or financing institutions/initiatives can begin to address these bottlenecks and overcome the challenges? What steps can they make?

For example: provide better training to their staff (capacity building) on how to understand and analyse financing options; adopt better outreach efforts to target financing institutions and initiatives in the energy sector; collaborate with bilateral and multilateral agencies to solicit for funding

10-If you had the opportunity to make some recommendations, how would you propose to make financing more easily available to SMEs in the energy sector?

Give three recommendations. These can include recommendations concerning the regulatory environment, and the need for capacity building.

12 ANNEXE 3: INTERVIEWS

ETHIOPIAN CLEAN COOKING ALLIANCE (ECCA)

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: ECCA Offices, Behind Bole Medhanialelem Church, 3rd floor

Date and time: Monday October 26th, 2020 – 15:00 to 16:00 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Konjit NEGUSSU (Director of ECCA) – konjitr@gmail.com

Topics:

- The Ethiopian Clean Cooking Alliance Association (ECCA) is an Ethiopian civil society organization (CSO) established in July 15, 2019. It counts 49 registered active members (2 Gov, 4 NGO, 2 Academia, 15 Private Sector, 26 Individual), led by Executive Committee.
- The choice of CSO status was driven by the increasing importance that such organizations are being given by the current government
- ECCA is working towards creating enabling environment and ensuring consistent use of clean cooking to significantly reduce harmful cooking emissions while providing benefits to health, environment, and climate. It does so by enhancing partnerships among members within the supply chain of clean cooking to support the adoption of clean cooking mechanisms, through the key mechanisms of networking, policy advocacy, capacity building, social mobilization, and knowledge management.
- EnDev is also active contributor to the ECCA, even though not as a member, to ensure its independence as CSO
- ECCA always approaches the sector through a double perspective of clean cooking solutions: through the type of fuel (biomass, LPG, ethanol, electricity, solar, etc), and through the technology (gasifiers, ICS, CCS, etc). Currently, ECCA is focusing on a gradual shift from biomass-based solutions, to cleaner and more modern fuels and technologies.
- The ICS sector in particular has been heavily supported over the last 30 years by different government ministries and EnDev, through commercial approach with decentralized production approach aiming at supporting small artisans across the country that could serve both rural and urban populations.
- It is estimated that some more than 1,000 of such small-scale artisans established by different stakeholders in the country, most of them producing less than 100 stoves per year, with production that is often disrupted over the year also due to the fact that most of these artisans also have other business activities (agriculture, commerce, other) on the side.
- At the moment, only few semi-industrial (mostly relying on labour and light machinery) manufacturers of cookstoves (such as Lakech, Obama, Tikikil) exist in the country. These include some manufacturers at *mercato*, which can rely on very cheap labour (one worker can produce as much as 20 cookstoves a day), and whose production is distributed all across the country with trucks, making them the largest manufacturers in the country. However, stoves like Mirt are manufactured using mould and concrete mortar (cement and sand) and produce at Woreda level to reach the end-users.
- One of the most unique products to Ethiopian, the biomass *mitad* cooker for the injera, sees limited opportunity for industrialization, due to its large size and heavy weight (~60 cm of diameter and 40 kg), which hinders the opportunity for centralization of production and transport.
- When looking at potential market opportunities for the sector, Mme. NEGUSSU see limited scope for semi-urban and rural artisanal manufacturers, whose market coverage is geographically limited in any case and there’s little opportunity for scale up through access to finance.
- Different story is for such semi-industrial producers, who could scale-up interventions, provided fuels are made widely available, and energy stacking becomes less recurrent, especially among urban users

(see, for example, unreliability of electricity supply, forcing users to ensure other sources of energy, such as ethanol from sugar molasse, which is scarce due to the non-operationalization of sugar factories, unsustainable LPG supply which is affected by FOREX)

- Specific to ethanol, the GAIA association is quite active in promoting such fuel. However, at the moment, ethanol for cooking is priced the same with ethanol for blending which is the power alcohol (99.9% purity) (capped by the Government at 11 ETB/l) but practically sugar factories do only supply technical alcohol (97% purity) for cooking which is not capped in price is sometimes more than three folds of the power alcohol price). The technical alcohol is good enough to be used for cooking but Sugar Corporation interrupted the supply of ethanol for cooking mentioning the current inability of the sugar factories to produce power alcohol as a reason. However, in addition to unsustainable supply of the fuel and such price is not competitive with other sources of fuels, such as electricity, and the ethanol-based cooking sector is not really taking off.
- Back to financing, some semi-industrial cookstoves producers approached DBE to applied to the same WB/DBE facility for solar companies, which was also open to cookstoves. The truth, however, is that none of them seems to be benefiting from the available finance. This situation needs to be assessed with DBE to address the gap such as it could be due to relatively hefty terms, that neither of such companies, which operate in a sector with very low margins, were capable to honour. Konjit recommends contacting Gogle Energy Saving Stove and Engineering PLCS, ECCA member, to gets hands-on experience.
- The resistance of adopting ICS/CCS loan product to MFIs portfolio is lack of adequate knowledge about the clean cooking solutions (fuel and/or stove) that they required to adapt to their system,
- Request from such companies were linked to investment capital to purchase machineries, rather than import components, since the sector is characterized by local manufacturing, rather than import. For this same reason, FOREX is less of a concern for cookstoves producers (compared, for example, to solar kits distributors), which might only need to access to it every now and then for investments.
- MFI is a critical market enabler that is used by small private companies to fund their growth, However, currently, it is very difficult to obtain financial support related to production, promotion, and distribution of ICS/CCS. Note that some MFIs have provided capital to ICS/CCS companies to increase their local manufacturing, but through common business product loans rather than designing specific loan products customized to the specific financial needs.
- Besides, small to medium sized enterprises often require relatively small loan amount which is not attractive to most MFIs.
- This said, the sector needs a wider support than just heavily concessional financial mechanisms to cope with very low margin rates. These include technical assistance, at all level, and labelling and standardization to allow quality producers to be acknowledged by the market and apply higher profit margins. PAYGO for LPG, for example, like the one piloted by BBOX in Rwanda, could also make the difference.
- MFIs are definitely one of those key players in the sector that could make the difference in scaling-up interventions. However, despite their overcapitalization (some of them now shifting to commercial banks) due to their crucial role in the country, they seem to be reluctant and little understanding of the needs of the sector, at the moment.
- Mme. NEGUSSU, in the role of director of ECCA, has shared with the assessment team a valuable list of partners that could be approached by the Assessment team for further investigation.

DASHEN BANK

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: Dashen Bank HQ, Addis Ababa, Retail and MSME office

Date and time: Friday October 23rd, 2020 – 10:00 to 11:00 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Tebebu SOLOMON (Chief – Retail & MSME Officer) – tebebu.s@dashenbanksc.com

Topics:

- DASHEN Banks is one of the major banks of Ethiopia
- According to Mr. Solomon, MSMEs need i) collaterals, ii) technical assistance to build stronger business cases, and iii) FOREX in case of importers
- The Gov’t of Ethiopia has been trying over the last years to help MSMEs on these 3 aspects, mostly through MFIs
- At the moment, however, poor financial literature by MSMEs, and lack of capacity to build strong business plans, forces banks like DASHEN to require collaterals in the range 100-130%
- When it comes to FOREX, accessing to diaspora and exporters’ accounts is not an option, as they are prevented from lending money to third parties, such as importers, as FOREX can only be used for own business activities.
- DASHEN is currently collaborating with Mastercard Foundation for a COVID-19 emergency facility to provide short-terms soft loans to MSMEs in need of liquidity, in which 50% of loans is covered by a guarantee funds of MF
- According to Mr. Solomon’ experience, an on-going DBE-WB facility to provide soft loans to MSMEs is struggling to uptake due to excessively strict due diligence criteria, which make MSMEs to look elsewhere, even if at slightly higher rates.
- Mr. Solomon thinks that GIZ could create a FX fund that could be hosted at Dashen, of which 60% could be used to provide loans to importers, and 40% as warranty fund

ETHIOPIAN DEVELOPMENT BANK (EDB)

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: Virtual Meeting on Microsoft Teams®

Date and time: Tuesday November 10th, 2020 – 10:00 to 11:00 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Elias ASNAKE (External Fund and Credit Management Directorate - Energy Coordination Team Manager) -eloasn@hotmail.com

Topics:

- DBE has several programs to support energy sector in Ethiopia, these are:
 - Rural electrification fund, operational since 2005 and until 2024, on behalf of MoWIE. The fund started supporting GenSet-based mini-grids, to then open up to solar home systems (SHS). To date, the programme has impacted 40,000 households connected with SHS, by providing financing to 696 cooperatives.
 - FOREX credit line by the World Bank, disbursed in two phases of 20 million USD each. As all funds have already been allocated, a new phase is now under appraisal. The difference between the first and the second phase is that the first phase required high collaterals, which only 9 importers were able to raise; in the second phase, a 4.5 mio USD collateral support facility was put in place and DBE used Bankers Association asset valuation manual rather its own, allowing more companies to access to credit. In total 32 enterprises benefitted from the facility. Also, repayments in Birr from importers were then used to finance MFIs, that could either support distributors, or provide end-users’ financing. 14 MFIs have benefitted from it.
 - A small UNDP-funded risk-credit guarantee fund, totalling to 1.42 mio USD. The facility mostly targets SMEs undertaking loans from MFIs and commercial banks.
 - Another small facility aiming at reducing the use of kerosene lamps across the country, financed through carbon financing.
- Other cross-sectorial funds such as one for women entrepreneurship and SMEs financing exist, on other donors financing (WB, JICA, etc)
- Through its programs, DBE usually provide interest rates equal to 12%, which has been lowered to 8,5% for private companies and for MFIs staining on 8% being impacted by the COVID-19 pandemic.
- When looking at distribution, Mr. Asnake stated the regional energy bureau are quite active in supporting local cooperatives to work with distributors in rural areas.
- The minimum loan requirements for distributors at the DBE, is 2,500 USD.
- The DBE/WB facility was open to modern cooking, too, but not a single company could access to it. DBE received one application, and whose business model was too weak to be supported. Also, Mr. Asnake hinted that most of these companies have very little collaterals, and they should be especially be supported in that regard.
- Looking at how GIZ could contribute to the sector, Mr. Asnake said that a guarantee fund would be a very much welcome addition to the new WB funds currently under appraisal, or in general to any other of their support programs.
- Also, Mr. Asnake said that more support should be provided to mini-grids all-across the sector, including capacity building at the MoWIE, the financial institutions, and private operators. As a matter of fact, DBE never received any loan request by such operators, and this is particularly concerning given the national targets re. off-grid by 2025.

ETHIO RESOURCES GROUP (ERG)

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: ERG Offices, Ethio-China Road (Wollo Sefer), Medina Building, 3rd Floor

Date and time: Thursday October 29th, 2020 – 09:15 to 10:15 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Hilawe TESEMA (Director of Projects, co-founder) –hilawe@ergethio.com

Topics:

- Ethio Resources Group (ERG) is an Ethiopian energy and environment company that offers research, advice and services to the growing renewable energy sector in Ethiopia and East Africa. ERG has contributed to more than fifty renewable energy and environment studies and projects in five African countries addressing the needs of half a million people
- ERG is active in mini-grids (as first mini-grid licensee in Ethiopia), and consultancy services. A&H Development Solutions PLC in clean cooking solutions.
- Mr. Tesema raised the point that there’s no shortage of finance opportunities in the sector, both in Ethiopia and elsewhere, but he raised some concerns about the sustainability and effectiveness of some of these mechanisms.
- For example, most financing is available to importers and final users, but not to distributors.
- Another example is the WB/EBD facility, which was on paper also open to cooking solutions, but the procedures were found too complicated and cumbersome for such companies to apply, as the MoWIE seems to show more preference for the finance to be used for solar products than cookstoves.
- In general terms, all decentralized activities such as the distribution of solar kits or improved and clean cookstoves usually require a bureaucratic process which involves going through the regional energy offices for their approval to operate, as well as MFIs for financing and final users reach out. But these processes are usually complex and long, and capacities lack in most of these institutions, making some regions more attractive than others, just because of simplicity of procedures (for instance, MoU templates are often not available, and vary from region to region). Some procedures such as product quality verifications that are done at Federal level organizations are duplicated at Region level as well. More technical support is needed, especially among regional energy bureaux.
- More on MFIs, it is acknowledged that the largest Government owned MFIs (on average, one per region), have benefitted of a lot of support over the last decade, making them heavily capitalized, and less and less interested in supporting MSMEs in favour of larger clients, which are easier to handle.
- However, Mr. Tesema sees an interesting market potential for rural SARCOs, usually available one per *kebele*, due to their strong local content and interest in supporting local economies through lower interest rates and job creation. However, these MFIs, despite their dynamism and goodwill, are often poorly capitalized and with strong needs for capacity building and technical assistance.
- Looking into PAYGO on direct company financing, given the current legal environment (VAT and taxes to be paid upfront, interests cannot be charged, inflation rate in the country), Mr. Tesema sees little potential for quick scale-up in the short term, and he believes MFIs, regardless of the type and scale, are, at least for the time being, important players across the value chain.
- RBF-financing mechanisms could also play a role.
- If there’s scope for sector support, according to Mr. Tesema, this is regulation. At the moment, 80% of the solar kits’ market in Ethiopia is composed by non-IEC compliant products, which, according to the current regulation, should not even enter in the country. On the other hand, there’s a tendency to over-regulate quality products, making them even less competitive compared to those that are not subjected to any sort of regulation.

- Similar considerations apply to mini-grids, where overly prescriptive regulation soon to be implemented (mini-grid directive, for example), might limit market expansion. This is specifically relevant when it comes to tariff-setting
- Focusing more on the cooking sector, Mr. Tesema, who is a sector-pioneer in Ethiopia, has little hopes for the larger uptake of quality products in the short-medium term, especially in rural areas. As a matter of facts, almost 30 years of projects in rural Ethiopia by several donors have brought very limited results, and mostly due to price and cultural attitudes.
- Mr. Tesema is also has a concern that increasing standardization and labelling of products could make a difference, as these will inevitably have negative consequences in terms of premium prices of products, whose reference markets are at the moment not willing to pay.
- Nonetheless A&H Development Solutions PLC continues to manufacture and import modern cooking solutions, currently betting on ethanol stoves for urban areas. This strategy aligns with the current market trends and government strategies, which should make bioethanol from sugar processing domestically available at large scale and affordable, including for cooking solutions. However, delays in the operationalization of the sugar facilities, and a very low cap price of 11 ETB/litre on fuel ethanol (99% purity) imposed by the Government around 9 years ago, is delaying larger market-driven production.
- Nonetheless, even by looking at the technical ethanol (95% purity), whose price is not capped by the Government and whose current factory price at 25 ETB/l, this is considered a very interesting fuel (cheaper than charcoal and LPG, according to a MECS Assessment on which Mr. Tesema contributed), and probably even more in the near future with the planned increase of electricity prices by the Government.
- However, it is also acknowledged that ethanol stoves, especially those of good quality likes the ones distributed by the GAIA projects some years ago), are of high price, and MFI would be needed. The same applies for any other similar high-quality stove, even with other fuels.
- Finally, Mr. Tesema hopes that import duty waiver is extended not only to solar products, but also to machinery for productive uses powered by electricity (grain millers, etc), if real impact is to be achieved for rural transformation and development.

FOSERA

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: Via phone + digital questionnaire

Date and time: Thursday October 22nd, 2020 – 11:00 to 12:00 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Thomas Koepke (General Manager at FOSERA Ethiopia Assembly Line) - thomas.koepke@fosera.com

Topics:

- FOSERA is a German company producing high quality, Pico PV, plug n’ play solar home systems with a long lifetime and flexible usage and extension.
- In Ethiopia, FOSERA set up an assembly line some 8 years ago as a way to overcome the limitations for foreign companies to operating in the sector, leveraging on the Gov’t opening and support to foreigners’ entry in national manufacturing activities. Since then, Mr. Koepke manages the facility in Bahir Dar. Given its pioneering role, FOSERA is now doing general sector development for those to come
- Since FOSERA Ethiopia does not currently export its products in the region, but it’s focused on the national market, the company has no right to access to FOREX accounts for imports, but for initial investments only, which limits its capacity to import components on rolling basis for its assembly line. Specifically: 1) *Capital Accounts*: Every foreign company gets one in the beginning where to transfer the investment funds. This money remains available over time and it can be used for any business related purposed, but this is not allowed to be used it as a “working account”, meaning to receive FOREX revenues onto it; 2) *Retention Account*: Only Exporters (and other recipients of FOREX, like grant recipients) get it. FOSERA got it as they got the Export permit to be at least theoretically allowed to export, and they use it for they grant money or in the rare occasion when NGOs pay for some systems for a project.
- On a side note, Mr. Koepke also presented limitations concerning FOREX bank accounts for exporters, whereby only 30% of the total amount can be retained in the country in FOREX, while the remaining 70% is converted into Birr by the national bank after 28 days if not used to place import orders that are strictly related to the business activity (retention account). Other FOREX sources available to the market come from Ethiopian citizens belonging to the diaspora, whose money is usually used to finance side import activities, sometimes through the black market. M. Koepke estimates that between 80 and 90% of imports are done by diaspora Ethiopian citizens.
- Besides that, FOSERA has been facing various challenges since the start of operations:
 - Applicability of duty and import waiver (SKD or CKD) to components that are not clearly associable to solar products (which are eligible for waivers) by customs agents; in order to overcome such problem, FOSERA started importing containers with all components in the exact number to assemble an equivalent number of products, hence proving that each single component shall be used to assemble solar products. But through this strategy, no spare parts could be imported for warranty purposes.
 - Difficulties to prove compliance with import quality standards of final products enforced by the authority, given final assembly occurs in the country and no independent certification body exists in the country
- As manufacturer and wholesaler, FOSERA has limited interest in retail, which in any case is precluded to international companies. The company is building on a series of partnerships with various retailers, including MFIs, and specifically ACSI (Amhara). In principle Mr. Koepe agrees that MFIs could be bypassed with positive effects for final users, but he also acknowledges the role that MFIs have in promoting in access to credit.

- In the specific case of ACSI (but not limited too), companies such as FOSERA are requested to lock 5% to 10% cash equivalent of their total sales for 2 years against early departure and impossibility to ensure warranty services.
- Mr. Koepe acknowledges that “*mercato* products” have flooded the country, but also that high quality products could never compete on the cash market, also in terms of volume due to FOREX limitations, and therefore it is less of a concern for him, in terms of competition. Also, low quality products have had the advantage to introduce solar PV technology to rural households, bringing needs in marketing and communication to the level of quality, rather than technology.
- FOSERA does not see lack of financing as a problem in the country, but rather lack of FOREX. Also, lack of collaterals is a problem for SMEs to access credit, whether in FOREX or in Birr. Allowing collaterals to be covered in cash in Birr would already be a way forward.
- As long as there were funds in there, the DBE/WB facility had reduced collateral requirements to 50%. Later this was reduced to even only 25%. For a very short moment (just to get rid of the last ones) they even introduced a 1:10 collateral support
- DBE/WB was a good programme, but collaterals were not linked to each import, but the whole amount requested for 2 years.

GREEN SCENE ENERGY (GSE)

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: Green Scene Energy (GSE) PLC offices

Date and time: Monday October 19th, 2020 – 08:30 to 09:30 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Rekik BEKELE (CEO at GSE) - info@greensceneethiopia.com

Topics:

- Green Scene Energy (GSE) PLC is an Ethiopian company availing affordable, high-quality solar-powered electrification to off-grid communities of Ethiopia.
- GSE deals with Lighting Global®-certified solar kits of the following brands: Biolite®, SunKing®, and partially FOSERA®. The CEO of GSE is also member of the Ethiopian Solar Association
- The largest competitors of GSE are illegally imported, low-quality solar solutions that can be found at “mercato” in Addis Ababa.
- GSE, through a previous company, also engaged in ICS. However, as they always seek commercial viability, and they noticed the sector is still heavily dependent on external aid and heavy subsidies, they dropped the sector.
- GSE is also among the first companies retailing through PAYGO. This was initially done on GSE financing, which allowed GSE to pilot and learn from it. After, to be able to scale up and access to additional sources of financing, GSE linked up with MFIs, which also benefitted from the expertise of GSE.
- At the moment, PAYGO is financed through MFIs, but the hope of GSE is to be able financing itself again. This is allowed by the current regulation even if they are not financial institutions, provided they don’t charge interest rates. However, they find a major constraint in the fact that even when retailing through PAYGO, current legislation requires companies to pay VAT upfront.
- In Ethiopia, we distinguish between government-owned and private micro-finance institutions (MFIs). The 7 government-owned MFIs have a regional scope due to their regional distribution across the country; the private ones are smaller, also in terms of financial capability, but they tend to more dynamic and flexible in terms of collaborations.
- While collaborating with Gov’t MFIs seems an obvious choice due to their extended country coverage, these are usually slow and bureaucratic, forcing GSE to start working with PEACE MFI, despite their limited presence in the country, and with which they set-up a PAYGO system
- SMEs distributing solar kits, and especially those offering PAYGO, collaborate with MFIs, which are generally quite well established in the country, to sell products on credit to final users. As a result, all major solar players operate in the same areas served by the MFIs – usually in the radius of 40 km or large villages – making competition limited to the same areas.
- GSE would like to be able to overcome this limitation and operate in areas currently not served by the MFIs. But to do so with PAYGO, GSE shall have enough upfront liquidity to be able to pre-finance products over 12 months, which is not the case now.
- Linked to the above, GSE struggles to raise capital, since the Investment Regulation No. 474/2020, Art. 4.1, 4.5 and 4.6, preclude financing and retail trade activities to foreign investors. That translates in the impossibility for GSE to obtain foreign loans or equity contributions, being limited to national loans in Birr.
- As a matter of facts, only diaspora Ethiopian citizens and exporting companies are allowed to have USD bank accounts in Ethiopia, under the assumption that these two categories are capable to bring USD in the country, through which finance additional business operations. Ethiopia citizens and non-exporting companies are not allowed to have USD accounts.

- GSE profited largely from the credit line for solar products set-up by the World Bank and hosted by the DBE over the last 2 years, which offered loans in USD with a tenure of 2 years, with a 6-month grace period, and a 10% per year interest rate. Despite the relatively hefty terms, to which add collaterals between 75% - 100% (either 100% in cash, or 75% equivalent in property assets – the remaining 25% covered by the programme) and a mandatory cash guarantee of 25% in Birr between the order placement and delivery in Ethiopia, such credit line was considered to be very successful and helpful to the sector.
- Whilst this fund is still operational, the remaining reserves are already allocated to companies, which are already paying interest on them, and will be using those in the coming months. No new applications are available.
- The WB-DBE fund also attracted many one-shot national importers normally not operating in the sector, who could benefit from the credit line, and after having whole-sold the stock in the country, left the sector again.
- The fund also provided cheap financing for end-users in Birr through MFIs, which contributed to the entering of the MFIs in the sector.
- The fund was supposed to be refinanced in June 2020, and GSE made sure to mobilize sufficient guarantees to access to it again. To date, however, this has not yet taken place, and GSE sees its supplies disrupted.
- “Luckily”, this happened in concomitance with the COVID-19, which massively slowed operations and made it extremely difficult for GSE agents to go to rural areas, especially because of some sort of reluctancy of rural consumers to engage with Addis-people, accused to spread the virus.
- Besides this fund, there are no structural facilities in place to support the sector, besides duty waivers on imports. Some occasional grants and tenders are launched in the country every now and then, but the sporadic of such interventions are considered not sufficient to sustain operations in the long term.
- It seems that UNDP has some credit line for working capital aimed at very small distributors (who could collaborate with GSE), but that collaterals are too high to become accessible for most players. AfDB seems to have announced a new guarantee funds, but not more information is available, at the moment
- Impact investors, such as RENEW, seem to only focus on exporters and foreign investors, due to their capacity to access FOREX.
- GSE is also the company who reached the final stage of negotiation with Ethio telecom to showcase and retail its products through the Ethio telecom existing distribution network. In exchange, Ethio telecom would require a margin on the retail prices. For GSE this is a unique opportunity to achieve its goal of targeting 600,000 HHs, equal to 10% of the potential market share of HHs supplied by solar kits by 2025 as per national targets
- However, not being able to access FOREX and place large orders for such ambitious collaboration, is threatening the whole project.
- To be able to attract additional funds, GSE is also exploring to start manufacturing locally, a sector where foreign investments are encouraged. However, based on the experience with FOSERA, which owns a locally manufacturing facility, it seems that import of components for assembly was found extremely complicated and expensive, hence making little sense of it.

MBIRR

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: MOSS ICT Consultancy offices, SNAP 2nd Floor Plaza, Bole, Addis, Ababa

Date and time: Monday November 9th, 2020 – 14:30 to 15:00 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Desta BAYISA (Deputy CEO at MOSS ICT Consultancy) –desta@mossict.com

Topics:

- M-BIRR is a mobile and agent banking platform provided to Ethiopian financial institutions by MOSS ICT
- MBIRR is the first service of its kind to establish in the country
- Like all other services in the country in the sector, MBIRR is an IT platform operating on cellular networks acting as service and transactional facilitator at the interface between financial institutions and final users
- As such, M-BIRR provides non-interest and interest-bearing wallet accounts on behalf of its financial partners.
- Accounts are hosted at the 6 MFIs partners of MBIRR, which are: ACSI, ADCSI, DECSI, OCSSCO, OMO, and PEACE.
- These MFIs interface through MBIRR and the service ensures full interoperability among these institutions, as well as any other institution that might join the platform in the future.
- MBIRR is also discussing with commercial banks to join the platform.
- The reason why MBIRR does not offer deposit accounts itself, is that compared to other countries where such services are offered and regulated by the Telco sector, in Ethiopia this relates to the financial sector.
- The financial sector being highly regulated and centralized in Ethiopia, MBIRR and likes are not accredited as financial institutions and cannot offer accounts to their users.
- However, a recent regulation by the Gov’t of Ethiopia just opened mobile money services including deposit account also to non-financial institutions.
- Whilst MBIRR will provide such accounts in the future and they will continue with their approach of being services providers, some competitors might.
- 5 years ago, MBIRR started a pilot collaboration with AZURI to distribute few hundreds Tier 1 SHS in the country, in collaboration with MFIs.
- While results were promising and demand was strong for their products, eventually AZURI had to withdraw from the country given the current legislation that precludes foreign investors to engage in retail in the country.
- AZURI offers a fully integrated platform offering PAYGO and monitoring services, and on which the integration with MBIRR was relatively straightforward.
- Mr. BAYISA himself was working at AZURI before moving to MBIRR, as regional director having worked in Kenya, Tanzania, Uganda, Ethiopia and Zambia.
- At the moment 7 solar distributors offer PAYGO and collaborate with MBIRR in Ethiopia, using ANGAZA and MOBISOL platforms. While integration was not as immediate as with AZURI, MBIRR is now fully compatible with these distributors
- These distributors have limited technical and financial capacities, and they have problems scaling-up interventions, also due FX issues
- Also, the current legislation is silent regarding products distributors offering leasing services such as the ones of PAYGO, allowing them to operate as such even though they are not financial institutions.
- Some of these distributors finance PAYGO on their own, by accessing credit facilities put at disposal by the DBE, other rely on MFIs and other financial partners

- MBIRR does not collaborate with any clean cooking distributor in the country, nor with mini-grid operators.
- Mr. BAYISA sees some crucial bottlenecks to the sector, mostly upstream in the value chain, access to FOREX for imports, Product availability being the most important one.
- Similarly, low capitalization and access to credit for distributors further precludes market expansion, as low purchase capacity further deters importers from placing large orders.
- Setting-up a distribution network and provide capillary after-sale services for high-quality products are also capital-intensive activities, which cannot be engaged by distributors, especially given they cannot rely on erratic supply by importers.
- For all these reasons, Mr. BAYISA believes that undercutting MFIs from the value chain in the short term is not likely to happen, as they provide both financing and distribution services to distributors.
- Also, MFIs in Ethiopia have an exceptional recovery rate of 95-96%, while distributors offering PAYGO services directly do not usually go beyond 80 – 83% in the best scenario. Hence, there's strong interest for distributors to work with MFIs.
- That is because MFIs have very strict due diligence processes for their customers and a wide and capillary network of loan recovery agents in rural areas, while PAYGO distributors usually have very simple and flexible contracts and limited local presence.
- MFIs also offer distribution services by leveraging on their existing presence across the country.
- Mr. BAYISA also acknowledges, however, that some of the national distributors rely too heavily on the distribution networks of the MFIs.
- MFIs' core business not being the distribution of solar kits, however, they usually pay little attention in the quality of products distributed, in the customer experience and after-sale services.
- This is inevitably going to have negative consequences in terms of sector' reputation, and distributors of high-quality products should be more involved in the distribution chain.
- So, while on a pure consumers' point of view undercutting MFIs would make sense in terms of final price, other crucial factors come into play.
- For all these reasons, MBIRR has been collaborating with MFIs for 10 years now.
- The main challenges relate to a very traditional, strict and bureaucratic structure characterizing most MFIs in the country.
- For example, MBIRR has been focusing on asking its partners to review their repayment policy, going for quarterly to monthly, or even weekly repayment periods. To date, only the collaboration with MFI PEACE succeeded and continues in this regard. A similar effort with ACSI OCSSCO and government affiliated MFI's has failed.
- M-BIRR has offered the platform that allows MFI's to collect loan electronically. However, MFI's are still willing to send out their loan officers in the rural villages to collect cash. There are so many other digitalization opportunities provided to MFI's through the M-BIRR platform. Their progress is slow paced, and MFIs are still working with limited number of mobile money agents and merchants. MOSS is looking into a new collaboration area as Super-agent to drive the slow-moving operation on behalf MFI's
- Similarly, MBIRR is looking into how collaborate itself with RUSACCO to become subagents on their behalf, profiting from their capillary presence in the country, which goes beyond the coverage of MFI. The structure would be then the following: MFI → MBIRR → RUSACCO
- Finally, Mr. Bayisa sees a tremendous potential for solar products applied to agriculture

MEGEN POWER

Purpose: Stakeholder meeting for “Scoping Assessment for setting up a “Financial System Development (FSD)” component at EnDev Ethiopia

Place: Café in Addis Ababa

Date and time: Wednesday October 21st, 2020 – 11:00 to 12:00 Ethiopia Time

Participants: Andrea RANZANICI (Project support expert at MARGE), Melessaw Shanko (CEO at MGP) - melessaw.shanko@gmail.com

Topics:

- Megen Power (MGP) is a consultancy firm active since the mid-1990s in the energy sector in Ethiopia, originally with a focus on clean cooking solutions, and recently also in solar kits. The CEO Melessaw was, back in his early career, an officer at the Ministry of Energy, and moved to private sector shortly after. The CEO of the Ethio Resources Group (ERG) also belongs to the same “batch” of experts, and as a matter of facts the two used to work together in the early times (and they still collaborate, each with his own company);
- Ato Melessaw raised concerns regarding the donors’ strategy over the last 30 years in supporting ICS in rural areas, which made the sector heavily dependent on aid. He rather suggests focussing on urban and peri-urban areas, in which (semi-)commercial models can be achieved.
- According to Ato Melessaw, quality assurance on solar lighting products is a major hindrance to the sector, as low-quality products imported illegally dump the market and create unfair concurrence.
- To his knowledge, Ato Melessaw is not aware of any on-going support project to the sector, since all past initiatives have come to an end and do not allow any new applications; he also raised the concern that these initiative were all sporadic one-off opportunities, and neither of them is structural in support to the sector.
- For example, the WB/DBE loan facility was extremely successful, and this despite the hefty repayment terms. To Ato Melessaw’s knowledge, collaterals requested to access such funds in the early phase were almost non-existent, but this differs from the information we received from other operators, raising questions on whether a low recovery rate might have pushed the programme to increase the collaterals. Such facility provided for loans in USD for importers, whose repayments in Birr were then used to provide loans to MFIs for final users.
- Another initiative, which also no longer accepts applications, is the Africa Enterprise Challenge Fund (AECF), on World Bank financing. The facility provided for a 5 mio USD grant to companies in the energy sector. Whilst the initial idea was to provide loans, the fact that the AECF is not physically present in the country and could not make further use of loan repayment in Birr (and USD would have not been possible), the focus shifted to grants. Each grant was composed of 2 funds, as per NBE regulations on FOREX accounts: one equal to 30% of the total in USD, and another one of 70% of the total also in USD, but convertible in Birr after 28 days, if not used by the grantee. 12 companies were selected for this first round. A second round, on DfID financing, should start in the coming months.
- Besides these opportunities, no other initiatives exist in the country to access FOREX for importers. As a result, importers usually wait between 9 and 12 months to obtain USD by the National Bank of Ethiopia, and usually in very limited amounts. A consequent risk is the support to a flourishing black-market, especially from diaspora citizens, how have access to USD, to national ones.
- This said, it seems that unless the Gov’t of Ethiopia addresses all these issues, it will be difficult to achieve a 35% off-grid electrification rate by 2025 through the contribution of the private sector.
- Looking into the current model, solar kits operators currently charge as much as 200% of margin on sales, with negative impacts for final users. One of the main reasons being that all these operators

operate through MFIs, which themselves charge some 18%-20% per year. However, undercutting MFIs is quite complicated in the short term, since:

- MFIs, and especially the Gov't ones, benefit from strong political support, and are considered preferred partners if businesses are to be successful
 - SMEs need strong financial capability to do so, which is not the case for most of them;
 - SMEs may not be capable to enforce payments default as much as MFIs do.
- However, PAYGO could be an answer to such limitations, allowing private distributors to undercut MFIs. Donors' support should go towards that direction.
 - In the 4 major regions, a bottom-up spontaneous platform between i) the regional energy agency, ii) the main regional MFI, and iii) the micro, small and medium enterprises regional agency (MSMEA) exist. Distributors willing to operate in those regions usually sign a MoU with this platform, under the agreement that i) Lighting Global certified products are used, ii) a minimum of 12-month warranty is provided (to this end, 10% of the profits are retained by the platform for the duration of the warranty to ensure compliance), and iii) the distributor would collaborate with the MSMEA partners for last-mile distribution. All distributors able to sign such MoU would be able to operate in the Region much more easily than those who don't.

DIGITAL QUESTIONNAIRES

Responses to the digital questionnaire can be found here:

<https://docs.google.com/forms/d/1MVvwykraV66xOQAP-HMIU5brmINGzy3s6-UeiiIT4MY/edit?usp=sharing>

13 ANNEXE 4: LEGAL FRAMEWORK APPLICABLE TO MINI-GRIDS

Legal framework

- a. The energy sector in Ethiopia is governed by the Energy Proclamation No. 810-2013 (Energy Proclamation) (as amended) and the Energy Regulation No. 447/2019 (Energy Regulation). The Energy Proclamation and Energy Regulation provide the regulatory framework for the generation, transmission and distribution of energy for both on grid and off grid energy including hydropower, solar, wind, geothermal and biomass.
- b. As a matter of policy, the transmission and distribution of energy through the integrated national grid is an activity reserved for the government of Ethiopia¹⁶ Whereas generation of electricity is open for the private sector. The government handles transmission and distribution network through the two public enterprises i.e., the Ethiopian Electric Power (EEP) which is responsible for generation and transmission of power through the national grid and the Ethiopian Electric Utility (EEU) which handles distribution to end customers.
- c. In terms of off-grid energy, generation, transmission and distribution of electricity is an area open for foreign investors. However, regulation of off-grid sector is at its early stages of development. While the Energy Proclamation and Energy Regulation provide general guidelines as to licensing procedures and tariff mechanisms, detailed rules have not yet been enacted. Currently, there are a number of draft directives¹⁷ prepared by the Ethiopian Energy Authority (EEA) awaiting final approval.
- d. The **Draft Directive on Mini-Grids** aims to regulate the development and commercial operation of mini-grids. It includes provisions on category of licenses, licenses class determined by capacity of energy to be produced, exclusive and non-exclusive licenses, tariff negotiation with communities, sale and transfer of mini-grid assets, customer complaint and grievance handling mechanisms, tariff guideline and methodologies and tariff review and approval procedures. The other three directives also aim to regulate similar activities for mini-grids and off-grid energy solutions. It is expected that these directives would be approved and enforced by the end of 2020.¹⁸

16 Although this is likely to change in the coming years due to the privatization and reform initiatives of Prime Minister Abiy Ahmed.

17 There are four draft directives. Proposals were made to consolidate these into one comprehensive directive.

1. Draft Directive for the Issuance of Licenses for Electricity Supply Industry – OFF-GRID
2. Draft Directive for mini-grid
3. Draft Directive for Quality of Service Standards for Off-Grid Supply
4. Draft Directive for Tariff Guidelines and Methodologies for Off-Grid Systems.

18 Interview with Ato Getahun Moges, Director General of the EEA.

- e. To date, there are only two private operators that have received licenses to operate mini-grids in Ethiopia. These were made based on direct negotiations with the EEA in a process that took several years to conclude. It is expected that many more private sector players will be joining the off-grid energy space in the coming years.

Policies and Programs

- a. **Growth and Transformation Plan (GTP I and GTP II):** the growth and transformation plan of the Ethiopian government development program that was launched in 2010 having two phases: 2010-2015 and 2015-2020. The main target of the plan is to make Ethiopia a lower middle-income country by 2025. In terms of the energy sector, the plans set out ambitious targets to meet local consumption demands and exporting to other countries. By 2020, Ethiopia's energy generation capacity was targeted to increase from 2,000 MW in 2010 to 17,000 MW, electricity coverage to reach 90% of the population.¹⁹ In addition, it sets out to diversify the sources of energy from a pre-dominantly hydroelectric power to other renewables resources including solar, wind and geothermal.
- b. **Ethiopia's 10-Years Perspective Development Plan (2020-2030):** the Ethiopian government, through the Planning and Development Commission, announced a draft 10-year development plan in June 2020.²⁰ This program was designed by the Planning Commission, which has invited consultations from stakeholders on the plan. As this document has not yet been public, the targets for energy sector are not yet known. However, an alignment of energy specific policies and reform programs are expected with the development plan. (*see below for more on power sector reform roadmap*).
- c. **National Energy Policy:** Ethiopia's national energy policy was drafted in 1994 and updated in 2013.²¹ While the 2013 version is currently in use, it has not yet received a formal endorsement from the government. The main vision of the policy is to make Ethiopia a renewable energy hub by 2015.²² Main objectives of the policy include improving the security and reliability of energy supply, access to affordable energy, ensuring energy sector financing and social and environmental sustainability of the energy supply. The policy highlights that access to affordable energy service coverage will be increased using both on-grid and off-grid electrification methods.²³
- d. **The National Electrification Program (NEP):** In November 2017, the Ethiopian government launched the NEP as an action plan for achieving universal electricity access nationwide by 2025.²⁴ 65% of access

19 Growth and Transformation Plan II 2015-2020, page 199

20 https://twitter.com/PDC_Ethiopia/status/1276389537208557577

21 Ministry of Water and Energy, Ethiopian National Energy Policy (2nd Draft), February 2013

22 Draft National energy Policy, Page 8

23 Draft National Energy Policy, page 30.

24 National Electrification Program (NEP) 2.0, Integrated Planning for Universal Access (2019)

provision is targeted with grid solution whereas 35% are expected to be sourced from off-grid solutions. NEP targets a grid connection roll-out program for scaling up connectivity and complimentary off-grid access program that will provide access to rural and deep rural households without grid connectivity. Both the on-grid and off-grid energy access targets envisage public and private sector participation to be achieved. NEP also targets 90% grid connectivity by the year 2030.²⁵

- e. **Public Private Partnership Policy (PPP Policy):** The Ministry of Finance designed a PPP policy in 2017 to meet the growing demand for infrastructure services and the need to diversify financing from the traditional public sources to private financing. While the infrastructure targets that were set by the GTP II were designed to be domestically financed, the PPP policy aims to leverage foreign direct investment and borrowing. Through the PPP policy, the government intends to promote the participation of the private sector in infrastructure service delivery.²⁶
- f. **Power Sector Reform Program [Draft]²⁷:** The Ministry of Water, Irrigation and Energy has drafted a 5-year power sector reform implementation roadmap. The draft is not yet completed and expected to be approved by the end of 2020. The main objective of the reform program is to ensure the financial sustainability of the power sector.²⁸ To achieve this, the program identifies key components for reform. These are (a) institutional framework and governance improvement (b) strengthening regulatory framework (c) restructuring utilities (d) introducing contractual framework (e) ensuring financial sustainability and (f) operational performance improvement. ²⁹

Energy Regulatory Authorities

- a. **Ministry of Water, Irrigation and Energy (MOWIE):** MoWIE is the ministerial body that was established with the mandate to lead the design and implementation of the country's energy policy.³⁰ MOWIE leads the development of electric power policies, laws and regulations to enhance generation, transmission and distribution of energy from water, wind and other alternative renewable energy sources.³¹ It is also responsible for capacity building in the energy sector, research, development and dissemination of renewable energy technologies.

²⁵ NEP 2.0, Section 3.2

²⁶ PPP Policy, page 7.

²⁷ The Ministry of Water, Irrigation and Energy is currently designing a Power Sector Reform roadmap for implementation. A draft has been developed and currently being reviewed by stakeholders.

²⁸ Draft Power Sector Reform Program – Section 3.3. page 15

²⁹ Draft Power Sector Reform Program – Section 3.3. page 4

³⁰ Definition of Powers and Duties of Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No. 1097/2018 (“Executive Proclamation”)

³¹ Executive Proclamation, Article 23(1)(f)

b. **Ethiopian Energy Authority (EEA):** The Ethiopian Energy Authority (EEA) was established by the Energy Proclamation and the Council of Ministers Regulation No. 308/2014. It is the key regulator of the energy sector in Ethiopia. The institutional set up of the EEA consists of the Director General and the Energy Board. The EEA has the following key mandates:

- *Issuing Directives and Codes:* EEA issues directives required to implement the Energy Proclamation and Energy Regulation.³²
- *Issuing licenses, and Certificate of Competencies:* pursuant to the Energy Proclamation, no person may generate, transmit, distribute, sell, import or export electricity for commercial purposes or engage in energy efficiency and conservation consulting, energy service contracting, energy audit and other related activities without having a licence.³³ Furthermore, any person that intends to carry of electrical work activities is required to obtain a certificate of competency.³⁴ Accordingly, the EEA administers and supervises energy sector licensing, renewal, cancellation and supervision of licensees for generation, transmission and distribution services.
- *Tariff Regulation:* The EEA is mandated to regulate tariff for both on-grid and off-grid energy. For on-grid energy services, the EEA reviews national grid related electricity tariffs and submits its recommendations to the government for approval. In terms of off-grid tariff regulation, the EEA issues and implements guidelines for the determination of tariffs.³⁵ Private developers are expected to submit their tariff proposals to EEA which, if approved, will be subject to review every four years.
- *Strategy Formulation and Energy Efficiency Regulation:* EEA formulates energy efficiency and conservation strategies. In addition, it designs codes such as grid codes, energy efficiency codes, technical inspection code and others.³⁶
- *Approval of Agreements:* EEA is empowered to approve power purchase and network services agreements.³⁷
- *Arbitration and Mediation:* EEA hears, investigates and, where necessary, mediates disputes between parties. The parties in dispute may be licensees or between licensees and customers.³⁸

32 Energy Proclamation article 40

33 Energy Proclamation, article 6

34 Energy Proclamation, article 11

35 Energy Proclamation, article 4(3)

36 Energy Proclamation, articles 4(4), (6)

37 Energy Proclamation, article 4(2)

38 Energy Proclamation Article 38 (1) 9(b)

- c. Furthermore, pursuant to the Investment Proclamation, EEA is empowered to issue and renew investment permits for foreign investors engaged in the energy sector. 39

Public Enterprises in the Energy Sector

- a. Public Enterprises are wholly state-owned commercial entities established by law to carry on, for gain, manufacturing, distribution, service rendering, or other economic related activities.⁴⁰ Entities established as public enterprises have their own legal personalities, having rights and duties, and liable only to the extent of their total assets. Public enterprises may conclude contracts in their own name including international loan agreements, sell and pledge bonds.
- b. Following the unbundling of the Ethiopian Electric Power Corporation (EEPCO) in 2013, the Ethiopian Electric Power⁴¹ and Ethiopian Electric Utility⁴² were established as two separate entities engaged in the power sector. EEP is primarily responsible for the construction, upgrading and operation of generation and transmission lines and substations above 66 kV. Further, EEP undertakes feasibility studies, design and survey of electricity generation, transmission, and substation and to contract out such activities. EEU is the utility company that is responsible for constructing and operating electricity distribution networks, purchasing bulk energy and distributing to end customers. Both EEP and EEU are accountable to MOWIE.
- c. The EEU has exclusive license to distribute electricity over areas where there is a grid access. As such, the law does not envisage for complimentary provision of on-grid and off-grid licensees.
- d. Currently, several mini-grids are being constructed by the EEU as part of an off-grid energy expansion. We understand EEU has been using an EPC modality to develop and operate mini-grids as a utility.

39 Investment Proclamation No. 1180, article 4(2)

40 Public Enterprise Proclamation No 25/1992, article 2(1)

41 Council of Ministers Regulation to Establish the Ethiopian Electric Power, No. 302/2013 (as amended by Regulation No. 381/2016)

42 Council of Ministers Regulation to Establish the Ethiopian Electric Utility No. 303/2013

14 ANNEXE 5: REGULATION OF FOREIGN INVESTMENT

Regulatory Framework for Foreign Investment

- a. The principal law governing the foreign direct investment in Ethiopia is the Investment Proclamation No. 1180/2020 (Investment Proclamation). There is a draft Investment Regulation (Draft Investment Regulation) and draft Investment Incentives Regulation that are expected to be approved by the Council of Ministers in the coming few months. These two regulations will replace the Investment Incentives and Investment Areas Reserved for Domestic Investors Council of Ministers Regulation 270/2012 (Investment Regulation) that regulates investment sectors and applicable incentives.
- b. The Investment Proclamation defines investment as “an expenditure of capital in cash or in kind or in both by an investor to establish a new enterprise, or to acquire, in whole or in part, or to expand or upgrade one that already exists.”⁴³ According to the Investment Proclamation, any investor may engage in any area of investment except where it is contrary to law, moral, public health or security.⁴⁴ There is a distinction between foreign and domestic investors.⁴⁵ Domestic investors are Ethiopian nationals or foreign nationals treated as domestic investors (for example, persons of the Ethiopian diaspora who have acquired the nationality of another country), and includes the Government and public enterprises⁴⁶, as well as cooperative societies.⁴⁷
- c. A foreign investor is defined as a foreigner⁴⁸ or an enterprise wholly owned by foreign nationals, having invested foreign capital in Ethiopia, or a foreigner or an Ethiopian incorporated enterprise owned by foreign nationals jointly investing with a domestic investor.⁴⁹
- d. Under the Draft Investment Regulation, certain areas of investment are expected to be reserved for domestic investors (these activities are mainly in the service and retail sub-sectors), and for joint-venture with domestic investors and joint venture with the government. However, the draft regulation is expected to liberalise a wide number of sectors for foreign investment, such as, education, health, services (management, energy services) and others. As noted above, for the energy sector, generation for on-grid and generation, transmission and distribution for off-grid is fully permitted for foreign investment.

43 Investment Proclamation, article 2(1)

44 Investment Proclamation, article 6 (1)

45 Investment Proclamation, article 2(5) (6)

46 Investment Proclamation, 2(1)

47 Investment Proclamation, article 2(5)

48 Investment Proclamation, article 2(6)

49 Investment Proclamation, article 2(6)

- e. The Investment Proclamation requires a minimum capital of USD 200,000 for 100% foreign owned investments. If the investment is a joint investment with a domestic investor, the minimum investment is reduced to USD150,000.⁵⁰
- f. The key regulatory authority responsible for administering and facilitating investment is the Ethiopian Investment Commission. EIC is accountable to the Prime Minister. For the energy sector, the Investment Proclamation has delegated its powers to the Ethiopian Energy Authority (EEA) for matters relating to energy projects.⁵¹ Thus, investors engaged in the energy sector will be interfacing with the EEA for the purpose of obtaining an investment permit and investment incentives.

Investment Incentives

- a. The Investment Proclamation and Investment Regulation offer fiscal and non-fiscal incentives for investors.⁵² The incentive regime is currently under review by the Ministry of Finance which has developed a draft regulation. The draft has not yet reached the Council of Ministers and it currently undergoing review. It is understood that the incentives that were currently available (see below) for the energy sector will be maintained in the new incentive regime.
- b. The main types of incentives available to energy investors are:
 - Income tax exemption: under the Investment Regulation, income tax exemptions ranging from 1 to 10 years is available for investors, depending on the type of project and the location of investment. The exemption can apply for new enterprises or to enterprises expanding or upgrading their investment. Additional exemption applies for investors exporting at least 60% of their products or services.⁵³ The generation, transmission and distribution of electricity is eligible for a four-year income tax holiday for projects located in Addis Ababa or surrounding cities. If the investment is outside of Addis Ababa, a five-year income tax exemption applies.⁵⁴
 - Loss carry forward: an investor who has incurred loss within the income tax exemption period will be allowed to carry forward such losses for half of the income tax exemption period after the expiry of such period.⁵⁵
 - Exemptions from customs duty: The Investment Regulation provides that investors are entitled to import capital goods and construction materials relevant for the establishment and/or expansion of their enterprise free of customs duty.⁵⁶

50 Investment Proclamation, article 9 (1)

51 Investment Proclamation, article 9 (2)

52 Investment Proclamation, article 19

53 Investment Regulation, article 5

54 Investment Regulation, Schedule, article 4

55 Investment Regulation, article 12

56 Investment Regulation, Articles 13 & 14

Tax Incentives

Solar equipment is exempted from duty, excise and sur tax.⁵⁷ However, solar panels are not exempted from value added tax. (VAT). VAT is applicable at a rate of 15%.⁵⁸

Repatriation of Funds and Obtaining External Loans

- a. Foreign investors are legally entitled to repatriate, in convertible foreign currency, any profits dividends, principal and interest payments on foreign loans, proceeds from transfer of shares or transfer of ownership, proceeds from the sale or liquidation of their enterprise.⁵⁹ In addition, expatriates may also repatriate their salaries and other payments accruing from their employment in Ethiopia.⁶⁰ In practice, this needs to be processed through the Ethiopian Investment Commission and the National Bank.
- b. All funds coming into the country must first be registered by the investment commission within one year of the investment.⁶¹ Failure to register would result in rejection of any application for repatriation later. Forex is availed on the basis of a priority list issued by a directive of the national bank.⁶² Accordingly, the directive provides a first, second and third priority rankings on the basis of which commercial banks should avail forex to their customers. Forex request for the transfer of profits and dividends are listed on the second priority list.⁶³
- c. The availability of forex in Ethiopia is one of the most persistent challenges facing foreign investors. Investors are faced with long delays in approval of forex for imports as well as repatriation of profits and dividends. The government has been undertaking several measures to alleviate the problem, namely through promotion of FDI and exports, but the issue persists. This is likely to continue in the short and medium term until the government opts to fully liberalize the currency.
- d. *Foreign loans*: foreign investors are entitled to obtain an external loan subject to the prior approval of the national bank.⁶⁴ The national bank of Ethiopia regulates the procedures for the recognition and registration of foreign loans. An external loan is defined as “a loan acquired from an eligible recognized lender and approved and registered by the national bank.”⁶⁵ Foreign loans could either be from a

57 Ethiopia Customs Trade Portal, <https://customs.erca.gov.et/trade/customs-division/tariff/search>

58 VAT Proclamation No.285/2002, as amended by Proclamation No.609/2008

59 Investment Proclamation, article 20

60 Investment Proclamation, article 20

61 Investment Proclamation, article 9(5)

62 National Bank of Ethiopia, Transparency in Foreign Currency Allocation and Foreign Exchange Management (as amended) Directive No. FXD/62/2019

63 National Bank Directive No. FXD/62/2019, article 6.1.1(b)

64 Investment Proclamation, article 21 (a)

65 National bank of Ethiopia, Directive No. FXD/47/2017 for Amendment of External Loan and Supplier Credit Directive No. REL/05/2002, article 2.4

recognized lending institution or a shareholder of a local company. Failure to comply with the requirement of registration would cause the denial of the repayment of such loans.⁶⁶

- e. In approving and registering a foreign loan, the national bank typically reviews the particulars of the loan agreement including interest rates, applicable charges, the loan disbursement and repayment schedule. Access to forex for repayment of principal loans and interest rates are not subject to the priority list described above. Instead, request for these payments will be made on demand basis.⁶⁷ It is important to note that there is a mandatory cap of debt to equity ratio of 60:40 on the debt to be acquired⁶⁸

Company formation

- a. The Commercial Code of Ethiopia provides for six forms of business entities. Out of the six forms, the most common business structure for foreign investors is a limited liability company, which can either be a Private Limited Company or a Share Company. A Private Limited Company (PLCs) can be formed with at least two members and maximum of 50⁶⁹ (natural or legal persons) with a nominal minimum paid up capital of ETB 15,000 (approximately USD 450). Capital contributions in-kind can also be made.⁷⁰ If any one of the members is a foreigner, pursuant to the Investment Proclamation, the minimum capital requirement will increase to 150,000 USD. Where all members are foreign, the minimum capital requirement will increase to 200,000 USD.
- b. A Share Company is a company whose capital is fixed in advance and divided into shares and whose liabilities are met only by the assets of the company.⁷¹ Share Companies must have at least five shareholders (with no maximum number of shareholders) and the minimum capital of 200,000 USD or full foreign owned companies and 150,000 USD for joint ventures with domestic investors. Contributions in kind are also possible in Share Companies.⁷²
- c. In order to legally operate in Ethiopia, a foreign investor must obtain a commercial registration and a business license.⁷³ The foreign investor may set up a subsidiary or a branch of the foreign parent company. The subsidiary could either take the form of a PLC or Share Company.

66 National bank of Ethiopia, External Loan Directive, article 3.4

67 National bank of Ethiopia, External Loan Directive, article 4.2.3

68 National bank of Ethiopia, External Loan Directive, article 4.2.2.

69 Commercial Code, article 510(2)

70 Commercial Code, article 519

71 Commercial Code, article 304(1) Commercial Code

72 Commercial Code, article 307(1)

73 Commercial Registration and Business Licensing Proclamation No. 980/2016, article 5

- d. For foreign investors seeking to enter the off-grid energy market, a commercial registration must be made at the Ministry of Trade and Industry. Furthermore, the company must obtain an investment permit from the EEA. These are typically straightforward processes that will take from 2-3 weeks to complete.
- e. Further, a generation, distribution and retail license must be obtained from the EEA. Given the lack of existing regulations and guideline in place for mini-grids, applications for mini-grid licenses are made on a case by case basis. These are likely to take several months particularly the negotiations over tariffs. The draft mini-grid directive provides that the EEA must issue (reject) a license within a maximum of sixty days following an application. However, the practice on the ground shows that the procedures at EEA takes longer period to complete.

CSOs Engaging in Business

- a. Under Ethiopian Civil Society Law, any civil society organization has the right to solicit, receive and utilize funds from any legal source to attain its objective.⁷⁴ Additionally, any CSO has the right to engage in any lawful business and investment activity in accordance with the relevant trade and investment laws in order to raise funds for the fulfilment of its objectives.⁷⁵ The CSO may engage in business by establishing a new company, acquiring shares in an existing company or as a sole proprietorship.⁷⁶
- b. However, CSOs that are engaged in business can only use the income derived from the business for the purpose of their non-for-profit work. It is not permitted to distribute or transfer income for the benefit of the members or workers of the CSO.⁷⁷

Acquisition of Land

- a. Ethiopia has a federal system of government in which the powers of the federal and regional states are clearly delineated. The nine regional states and two administrative cities operate autonomously with their own system of governance. In terms of land acquisition and administration, regions have greater powers. The power to “enact laws for the utilisation and conservation of land and other natural resources, historical sites and objects” is assigned to the federal Government.⁷⁸ Regional governments are empowered “to administer land and other natural resources in accordance with Federal laws”.⁷⁹ Based

⁷⁴ Organizations of Civil Societies Proclamation No.1113/2019, article 63(1)(c)

⁷⁵ Organizations of Civil Societies Proclamation, article 63(1)(b)

⁷⁶ Organizations of Civil Societies Proclamation, article 64 (1)

⁷⁷ Organizations of Civil Societies Proclamation, article 64 (5)

⁷⁸ Ethiopia Constitution, article 55

⁷⁹ Ethiopia Constitution, article 52(2)(d)

on a general legal framework set by the federal laws, regional governments have their own set of laws regulating land lease and access within their jurisdiction.

- b. Therefore, for projects located in regional states, access and acquisition of land will be subject to local regional rules. Typically, rights to land will be acquired through execution of a land lease agreement with the relevant regional office and issuance of a title certificate.

Public - Private Partnerships (PPPs)

- a. The establishment of a PPP regulatory regime in Ethiopia is a recent development. In 2018, the Ministry of Finance (MOF) designed a PPP policy which was followed by the enactment of the first PPP Proclamation.⁸⁰ MOF issued a PPP Directive to further regulate the procurement and administration of PPP projects in Ethiopia. Prior to 2018, few Independent Power Projects (IPPs) were procured by the government based on the federal procurement laws existing at the time. Through the new PPP regime, one PPP project has so far been awarded. In 2019, the PPP unit announced 17 pipeline projects to be procured under a PPP modality out of which 14 were in the energy sectors (solar, hydro and wind).
- b. The PPP Proclamation defines PPP as a long-term agreement between a contracting authority and a private party under which the party agrees to perform a public service activity that would otherwise be carried by the government. The private party will receive a benefit by way of compensation, tariffs or fees collected from consumers or end users.⁸¹ PPP may involve the design, construction, financing, maintenance or operation of a new infrastructure facility or the rehabilitation, modernization, expansion of an existing infrastructure facility.⁸² It may also be procured for the administration or management of an infrastructure facility. The law provides that PPP projects may be concluded for a duration of provides a mandatory range of 20 - 30 years.⁸³ On exceptional cases and where the special nature of the project demands, a PPP project agreement may be concluded for a duration of less than 20 years.⁸⁴
- c. Under the PPP legal regime, the key institutions that are responsible for the design and implementation of PPP projects are the PPP Board (high level government entity), PPP Directorate-General (PPP-DG) and the contracting authority (typically a public enterprise) which will be a party to the PPP Agreement. In principle, the law provides that all PPP projects must be procured through an open bidding procedure with prequalification⁸⁵ PPP-DG is obliged to abide by the principles of transparency, free and fair competition and equal opportunity. If an open competitive bidding is not practicable on exceptional

80 PPP Proclamation No. 1076/2018

81 PPP Proclamation, article 2(12)

82 PPP Proclamation, article 5

83 PPP Directive, article 26

84 PPP Directive, article 26(2)

85 PPP Directive, article 19(1)

grounds provided by the PPP Proclamation, the PPP-DG is permitted to proceed with other forms that include: (a) Two Stage Bidding (b) Competitive Dialogue (C) Direct Negotiations and (D) Unsolicited proposals.

- d. PPP procurement processes are quite prescriptive and typically take 18-24 months to reach commercial close. The process is centralized within MOF with close involvement and collaboration of the contracting authority. For energy projects, PPP arrangements have been made only for on-grid energy generation with the EEP serving as the off-taker. Tariffs are determined on a competitive basis during the bidding process.

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Dag-Hammarskjöld-Weg 1-5
65760 Eschborn
Germany
T +49 61 96 79-0
F +49 61 96 79-11 15
E info@giz.de
I www.giz.de

Contact

Energising Development Ethiopia
T +251 11 645 10 20
E endevelop.ethiopia@giz.de
I www.endevelop.info
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Authors: Marge Energie, Environment &
Development Durable