

# USAID Transform WASH

Ethiopia's Business Environment and  
How it Influences WASH Market  
Development



Learning Note, September 2020



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## Copyright and Publisher

USAID Transform WASH aims to improve water, sanitation and hygiene (WASH) outcomes in Ethiopia by increasing market access to and sustained use of a broader spectrum of affordable WASH products and services, with a substantial focus on sanitation.

Transform WASH achieves this by transforming the market for low-cost quality WASH products and services: stimulating demand at the community level, strengthening supply chains, and improving the enabling environment for a vibrant private market.

USAID Transform WASH is a USAID-funded activity implemented by PSI in collaboration with SNV, Plan International, and IRC WASH. The consortium is working closely with government agencies, including the Ministry of Health, the Ministry of Water, Irrigation and Electricity, the One WASH National Program, and regional and sub-regional governments.

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This learning note explores the challenges to the business environment in Ethiopia and highlights opportunities for growth and investment into WASH products and services.

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## Abbreviations

<b>ACSO</b>	Agency for Civil Society Organizations
<b>CBE</b>	Central Bank of Ethiopia
<b>CBO</b>	Community Based Organizations
<b>CLTSH</b>	Community-Led Total Sanitation
<b>EFDA</b>	Ethiopian Food and Drug Authority
<b>ETB</b>	Ethiopian Birr
<b>FDRE</b>	Federal Democratic Republic of Ethiopia
<b>FMOH</b>	Federal Ministry of Health
<b>Forex</b>	Foreign Exchange
<b>GDP</b>	Gross Domestic Product
<b>GTP</b>	Growth and Transformation Plan
<b>IGA</b>	Income Generating Activity
<b>IP</b>	Intellectual Property
<b>MDG</b>	Millennium Development Goals
<b>MFI</b>	Microfinance Institution
<b>MSE</b>	Micro or Small Enterprise
<b>NGO</b>	Non-governmental Organization
<b>ODF</b>	Open Defecation Free
<b>PSNP</b>	Productive Safety Net Program
<b>SACCO</b>	Savings and Credit Cooperatives
<b>SDG</b>	Sustainable Development Goal
<b>SEE</b>	Social Enterprise Ethiopia
<b>SILC</b>	Savings and Internal Lending Community
<b>TSEDU</b>	Total Sanitation to End Open Defecation and Urination
<b>TVET</b>	Technical and Vocational Education and Training in Ethiopia
<b>UNICEF</b>	United Nations Children's Fund
<b>VAT</b>	Value Added Tax
<b>VSLA</b>	Village Savings and Loan Association
<b>WASH</b>	Water, Sanitation and Hygiene
<b>WHO</b>	World Health Organization

# 1. Introduction

## 1.1. Background

Ethiopia has greatly reduced the proportion of its population who practice "open defecation" from nearly 80 percent in 2000 to less than 23 percent in 2017. However, much of this improvement involved installation of unimproved household toilets, meaning that fecal waste is still open to the environment and is a potential source of disease-causing pathogens. Diarrheal diseases are Ethiopia's third leading cause of under-five mortality, causing around 70,000 deaths per year (JMP, 2017).

Unimproved toilets also frequently degrade and do not constitute a sustainable solution, nor do they meet the standard of "basic sanitation" service which is incorporated in the Sustainable Development Goals (SDGs). Only about seven percent of Ethiopia's population of over 100 million currently has access to basic sanitation – a situation that impacts health, safety, finances, and living conditions (JMP, 2017).

To meet the ambitious targets of the Sustainable Development Goals (2030) and the National Open Defecation Free (ODF) campaign (2024),<sup>1</sup> the Government of Ethiopia has called for active participation of public sector, non-governmental organizations (NGOs), community-based organizations (CBOs), private sector companies, and others to provide support and services.

The USAID Transform WASH Activity aims to help Ethiopia reach universal access to basic sanitation and hygiene services, as outlined in the country's 2<sup>nd</sup> Growth and Transformation Plan (GTP II), the National ODF Campaign, and consistent with SDG Goal 6.2. This activity, which is being carried out in partnership with the Federal Ministry of Health (FMOH) and other government

and private sector partners, is helping establish a strong enabling environment for businesses which provide affordable water, sanitation and hygiene (WASH) products and services. Transform WASH is active in 41 woredas located in eight regions of the country (plus the Dire Dawa municipality) and is now in its fourth year of a five-year lifespan.

Strengthening private sector enterprises and establishing effective business models is a key focus of the project. Owing to the country's challenging sanitation situation, Transform WASH has a strong focus on that sector, including production, distribution, sales, and installation of affordable sanitation products and services. Creating consumer demand for sanitation is another principal component, carried out using a combination of Community-Led Total Sanitation and Hygiene (CLTSH), promotional efforts by the Health Extension Program, local sales agents, and actions taken by the business entrepreneurs themselves.

Though much progress has been made in improving access to WASH products so far, key challenges remain such as access to foreign exchange currency, import of raw and finished goods, intellectual property protection, business start-up costs, and others - which are discussed in the following sections.

The purpose of this Learning Note is to explore these challenges in the private sector enabling environment, as well as to highlight opportunities for growth and investment in the WASH sector. A strong private sector will not only help expand access to critical WASH products and services – but also will help Ethiopia to realize its ODF goal and to achieve GTP II and SDG targets.

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<sup>1</sup> Ethiopia's National Open Defecation Free Campaign, which is also known as "Total Sanitation to

End Open Defecation and Urination – 2024" (TSEDU).

## 1.2. Methodology

Information used to formulate this paper was gathered from document research and augmented by in-depth interviews with more than twenty key informants in Ethiopia and the East Africa region. Informants included individuals in government agencies responsible for managing the WASH sector; companies that manufacture, import or market safe water and sanitation products; international NGOs involved with sanitation and financing interventions; and international organizations supporting the WASH sector and promoting private sector initiatives.

Questions posed to these experts included:

- How would you describe the business environment in Ethiopia, and how does it affect WASH businesses and their ability to get products to market?
- What are the key challenges businesses face in starting or expanding WASH businesses, and getting products to market?
- What strategies could be employed to more rapidly expand the WASH marketplace, and encourage the growth of enterprises in that market?

## 2. Economic Situation in Ethiopia

Ethiopia is Africa's second most populous nation (after Nigeria) with a population of 112 million people, and its economy is the fastest growing in the sub-Saharan region - (nine percent annual growth during the decade leading up to 2018). Despite these gains, the country still ranks as one of the world's poorest countries, with an average per capita income of US \$790 (World Bank, 2019). And although Ethiopia's economy has been growing faster than other economies in the region, the growth in (Gross Domestic Product) GDP has not translated directly to corresponding levels of poverty

reduction. Nearly one quarter of the population lives below the international poverty line, and proportionately more of the poor live in rural areas (World Bank, 2016).

Achieving universal access to basic WASH services in Ethiopia will likely require further development of the country's private sector. At present, sectors such as banking, telecommunications and transportation are dominated by government-owned enterprises. A lack of competitors constrains development of manufacturing, job creation and growth of exports. Ultimately, this limits the country's trade competitiveness, contributes to the trade imbalance, and reduces the country's resilience to economic shocks. The Government of Ethiopia is therefore strengthening its focus on expanding the private sector by encouraging more foreign investment, establishing industrial parks, and pursuing other market-driven initiatives (World Bank, 2019).

With almost 50 percent of Ethiopia's population under the age of 18, thousands of new jobs must be generated every year just to keep up with population growth. A key economic policy of the government, therefore, is to transform Ethiopia into a manufacturing hub in order to create more employment opportunities. And although relatively modest in scope, Transform WASH (and similar private sector WASH initiatives) align with and support this national economic agenda.

There are a number of government agencies that support and regulate the country's economy. These include:

- **Ministry of Finance:** Responsible for general financial management and setting national economic policy.
- **Ministry of Trade and Industry:** Responsible for managing the country's trade system and for increasing foreign exchange earnings.

- **Ethiopian Revenues and Customs Authority:** The agency within the Ministry of Revenues which is responsible for raising funds through customs duties and domestic taxation.
- **Ethiopian Investment Commission:** Responsible for promoting investment in Ethiopian industries and enterprises as well as setting regulations governing how foreign and domestic investors can operate.
- **Ministry of Urban Development and Construction:** Responsible for promoting urban development, and as a poverty reduction mechanism is also responsible for the registration and administration of micro and small enterprises (MSEs).
- **Civil Society Organizations Agency:** Responsible for overseeing the registration and reporting of all civil society organizations (CSOs). Formerly known as the Charities and Societies Agency.
- **Ethiopian Intellectual Property Office:** Facilitates issuing and legal protection of patents, trademarks, and other intellectual property.
- **Ethiopian Food and Drug Authority:** Responsible for certifying certain WASH products, like water quality testing and treatment technologies.

### 3. Business Environment

The Ethiopian government has ambitious economic and development goals and is actively encouraging investment (foreign and local) into specific sectors. For example, industries such as manufacturing of plastic products have been granted exemption from customs duties on imported equipment as well as favorable tax treatment and other incentives, such as access

to land. Such incentive schemes are justified based on expected earnings of hard currency from exports. However, to qualify for an exemption from customs duties and other taxes on imported equipment, an investment needs to be valued at more than \$200,000, and the company must employ a permanent staff of at least 50 Ethiopian nationals.<sup>2</sup> This kind of incentive fails to reduce prices in a nascent, price-sensitive consumer market like the one that exists for WASH products in Ethiopia.

Ethiopia's WASH market potential is extensive. The country met its Millennium Development Goal (MDG) for drinking water supply, yet only 63 percent of urban residents and *four percent* of rural residents have access to safely managed water supplies.<sup>3</sup> Ethiopia did not meet its MDG for sanitation and has a long road ahead to meet the even more ambitious sanitation and hygiene SDGs. Only about *seven percent* of Ethiopians currently have access to basic sanitation service, and over 20 percent of the country still practices open defecation (JMP, 2017).

The sections which follow below present the key findings from document research and consultations with a wide range of business experts. These sources identified the following as the principal challenges facing WASH businesses in Ethiopia:

- Access to foreign exchange<sup>4</sup>
- Taxes and tariffs
- Intellectual property protection
- Business registration and start-up requirements
- Business knowledge and skills
- Import challenges and uncertain demand
- Business and consumers financing

<sup>2</sup> Ethiopian Investment Commission website ([www.investethiopia.gov.et](http://www.investethiopia.gov.et), retrieved in Aug 2020)

<sup>3</sup> Safely managed water supply is drinking water from an improved water source located on premises and available when needed and free of fecal and priority contamination.

<sup>4</sup> Access to Forex is also linked to a range of other challenges, including profit repatriation, royalty payments, import of raw and finished goods, and others which are reviewed further in Section 3.

### 3.1 Access to foreign exchange

The national currency, the Ethiopian Birr (ETB), must be converted to a “hard currency”<sup>5</sup> through the foreign exchange market during any international transaction, such as purchase and import of raw materials or goods from outside of Ethiopia. The country imports significantly more goods than it exports (\$15 billion in imports vs. \$2 billion in exports in 2018). The trade deficit, which has hovered around \$12-13 billion per year since 2014, means that Forex (Foreign Exchange) is generally in high demand and in very short supply, and is exacerbated by below-market exchange rates (World Bank, 2018).

The Birr was devalued by 15 percent in 2017 and has continued to depreciate; analysts predict that the currency will now undergo a “managed devaluation” to encourage more foreign investment and address the country’s trade imbalance (World Bank, 2017b). Devaluation of the Birr requires purchasers of imports to use an ever-increasing amount of ETB to obtain the same amount of hard currency, effectively increasing the cost of all imports and decreasing the price of exports.

For Ethiopia-based businesses that require imported goods or materials, accessing hard currency through the Ethiopian banking system is often identified as their biggest challenge, as some sectors and businesses are prioritized over others. “All transactions requiring foreign exchange are not created equal,” describes a contributor to the Ethiopian Business Review.

Forex is tightly controlled in the banking system. A major portion of available Forex is earmarked for national infrastructure projects, such as the Renaissance Dam and other national priorities. Thirty percent of Forex coming into commercial banks is

transferred to the Central Bank of Ethiopia (CBE), which earmarks it for purchase of strategic materials such as fossil fuels. The remaining Forex is then allocated to businesses requesting it, according to prioritization rules. Banks have “allocation committees” that are responsible for matching available Forex with submitted applications. Prioritization tends to follow a basic system:

1. Priority allocations, including external debt repayments (closely monitored by CBE) and payment of foreign employees.
2. Materials considered “essential imports”, such as fuel and pharmaceuticals, agriculture and manufacturing inputs, equipment and spare parts, profit and dividend transfers, nutritional foods for infants, and educational materials.
3. Other “non-essential” requests (Lloyd and Teshome, 2018).

Forex requests from non-strategic businesses or for “non-essential” purposes must, therefore, be queued and wait their turn for available funds. Businesses often wait many months for Forex and may not have a clear idea when or how much will become available. When businesses do receive an allocation, they may be required to use it quickly (i.e. within a 14-day window), and they may not receive the full requested amount. These Forex access challenges affect a business’s ability to respond to orders, expand operations, maintain positive business relationships (e.g. making payments on time) and to remain competitive. Some businesses operate at a fraction of their production capacity due to Forex challenges.

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<sup>5</sup> A “hard currency” is money issued by a nation or group of nations that is seen as politically and economically stable, and which is globally traded, like

the British pound, the U.S. dollar, the Euro, the Japanese Yen, etc.



### 3.2. Repatriation of profit

Repatriation of profit refers to the transfer of profit earned in Ethiopia and sending it in hard currency back to a business's home country. Under Ethiopian law, foreign investors have the right to repatriate:

- profits and dividends accruing from an (approved) investment;
- principal and interest payments on external loans;
- payments related to technology transfer or management agreements;
- proceeds from sale or liquidation of an enterprise;
- proceeds from sale or transfer of shares or of partial ownership of an enterprise to a domestic investor;
- compensation paid to a foreign investor.<sup>6</sup>

Officially, there are no restrictions on the amount of profit that can be repatriated, but in practical terms business owners expressed concerns regarding limits resulting from the shortage of hard currency, and the relatively low priority placed on this type of Forex allocation. Given that Forex is closely scrutinized, businesses also must carefully comply with regulations regarding registration, permitting, periodic auditing, payment of taxes and other obligations (Ibex Frontier, 2017).

### Royalty payments

Royalties are payments made by one business to another in exchange for the right to use that business's intellectual property (such as a copyright, trademark or patented design). Ethiopian law permits royalty payments for the right to use a patent, invention, design, or a secret formula or process.<sup>7</sup> A five percent tax is levied by the government on royalties paid by an

Ethiopian entity as well as on the non-resident entity who is receiving them (Haile, et al., 2018).

Apart from the taxes levied, Ethiopian law does not seem to place any restrictions on royalty payments to foreign patent holders and allows for such payments to be made in Forex. Specifically, the National Bank considers royalty fees as "invisible payments" that are allowed on demand.<sup>8</sup> In practice, this means that foreign-owned businesses are likely to experience challenges receiving royalty payments due to the chronic Forex shortage in the country.

### 3.3. Import tariffs and taxes

To promote domestic manufacturing, the government follows an "import substitution" model, using import tariffs (duties) to raise the cost of imported finished goods; and selectively reducing duties on imports of raw materials used to manufacture goods domestically.

Goods imported into Ethiopia are subject to up to five different types of tariffs and taxes, including customs duties, value added tax, surtax, excise tax, and withholding tax – all of which generally are added into the retail sales price paid by consumers.

**Customs duties** applied to an imported good can range from zero to 35 percent, depending on how government classifies the item – and whether it's considered a material or raw input, which will be further developed locally, or a finished product to be sold directly.

**Excise tax** is typically levied on items considered "luxuries," (e.g., perfumes), goods that are hazardous to health (tobacco products), or goods that cause social problems (alcoholic beverages).

<sup>6</sup> Investment Proclamation No. 1180/2020.

<sup>7</sup> Income Tax Proclamation No. 979/2016.

<sup>8</sup> Directive No. FXD/46/2017.

**Value added tax (VAT)** of 15 percent is levied on imported goods, as well as on all domestic sales transactions when products are sold and change hands.

**Surtax** is a flat 10 percent fee used to raise additional revenue on certain products. It is based upon the sum of customs value, customs duty, excise tax, and VAT. Some products have been exempted from surtax, incl. fertilizer and petroleum (Kebede, 2019).

**Withholding tax** of three percent is applied on the customs value of imported items, and a tax of two percent on goods and services purchased locally.<sup>9</sup>

### Tariff and tax relief and reform

An example of how taxes and tariffs affect the sanitation sector is provided by the SATO pan, which is currently imported into Ethiopia at a price of around 100 ETB from a manufacturer in Kenya.<sup>10</sup> SATO pans are classified as “finished products” so they are subject to the following tariffs and taxes:

- Customs duty of 30 percent
- VAT of 15 percent (at each point of sale)
- Surtax of 10 percent
- Withholding tax of three percent.

With all relevant tariffs and taxes applied to this product (and no credits applied for previous VAT payments) as well as profit margins, the pan's price rises from around 100 to nearly 400 ETB full retail price to the final purchaser (Kebede, 2019).

In the interest of keeping the price of SATO pans as low as possible (to help establish

them as a new market entry in Ethiopia) the government has permitted the first few rounds of bulk imports to be exempt from customs duties; however, a long-term solution is not yet in place.

The government is presently engaged with interested parties in proposals to reduce or eliminate customs duties on certain imported WASH and menstrual hygiene products as well to reduce or eliminate certain taxes on a range of domestically-produced WASH products, such as menstrual pads and household water treatment products.<sup>11</sup> The proposed products for tariff and tax relief are relatively low-cost items aimed at base-of-pyramid consumers.

A long-term solution to the tariff and tax issues on WASH products will require that the Ethiopian Revenues and Customs Authority and Ministry of Finance get involved and, for example, re-classify certain products as “priority” items and take other relevant steps to help keep the cost of these products as low as possible.

### 3.4. Value added tax

Value added tax (VAT) accounts for 41 percent of total federal revenue from domestic sources, thus is a very important income source for government. VAT is applied on imports and all subsequent product sales transactions.<sup>12</sup> Some outlets and retailers may be exempt from charging VAT (when annual turnover is less than ETB 1 million),<sup>13</sup> and instead pay a turnover tax (similar to a sales tax) of two to 10 percent.<sup>14</sup>

<sup>9</sup> Income Tax Proclamation No. 979/2016.

<sup>10</sup> The SATO (Safe Toilet) pan is a low-cost molded plastic toilet pan which has a self-sealing trap lid to shut out flies, other insects, and odors. The pan requires very little water for flushing and cleaning.

<sup>11</sup> In 2019, a draft submission document requesting for tax removal on sanitary products has been submitted to the Ministry of Finance by the Ministry of Women and Children Affairs and Ministry of Health.

<sup>12</sup> In principle, it should be possible to deduct VAT charges paid in previous transactions throughout

the value chain. However, in practice this procedure, which requires accurate receipting and reporting, is not always adhered to.

<sup>13</sup> In February 2018, a Directive was issued by the Minister of Ethiopian Revenue and Customs Authority that raised the threshold for businesses to register for VAT payments from ETB 500,000 to ETB 1 million.

<sup>14</sup> Turnover Tax is assessed on gross receipts, as per the Turnover Tax Proclamation No. 308/2002 and Amendment No. 611/2008.

Although there are procedures for adjusting VAT payments based on prior amounts paid, many businesses likely do not follow these procedures due to a lack of understanding on how the process is administered (Kebede, 2019). The consumer ultimately covers the cost of VAT and all other applied taxes.

### 3.5. Intellectual property rights and protection

Intellectual property (IP) rights are granted to persons or companies for creating a design, invention, process, or work of art or music. IP rights are awarded through a legal process, and generally give the applicant exclusive rights over use of the creation for a specified period of time. Patents, copyrights, and trademarks are examples of legal mechanisms that codify IP rights.

IP rights for industrial designs enable companies to earn recognition and/or financial benefit from their inventions or creations. The Ethiopian Intellectual Property Office registers intellectual property protections under the Patent Act.<sup>15</sup>

Two types of IP protection are most common with respect to WASH products:

**Patent of Invention:** This patent applies to a first registration of a piece of intellectual property invented in Ethiopia or for IP that is registered in Ethiopia *within 12 months from successful first registration in another country*. A patent of invention is granted an initial period of protection of 15 years and can be extended for another five years.

**Patent of Introduction:** This is used for protected inventions from abroad that will be introduced to Ethiopia. A patent of introduction is valid for a maximum of 10 years. However, patent owners must file to extend this protection every year - after the third

year - and pay relevant maintenance fees. For some patent owners, the annual renewal process may be perceived as a risk and threat to their IP protection. For example, in the United States, depending on the patent, protection is granted for 14 to 20 years (with periodic fees) (STOPfakes.gov, 2016).

Most locally registered businesses interviewed for this study found the application process for patents to be relatively straightforward. The application process requires a certificate of incorporation, suggesting it is advantageous to be a locally registered business or joint venture, the latter being a foreign business with a local counterpart.

For a joint venture, both the patent owner and the local partner are listed on the registration, implying that the local partner also would acquire the patent rights. Some patent owners have cited the joint venture modality as high risk in terms of IP protection.

There also were concerns raised regarding whether IP rights are adequately protected or enforced, once granted. However, some experts say that IP rights provide less protection than expected, since nearly any product can be copied with minor variations to circumvent patent protection. In practical terms, even if a product generates copycats (imitations), the original product may have years of advantage over its competitors. Nevertheless, businesses that have invested extensively in design innovations and their “brand” need to be able to protect those designs and brand names and will continue to rely upon patents and royalty payments to maintain their ability to operate competitively in the market.

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<sup>15</sup> Patent Act is also known as the Proclamation concerning Inventions, Minor Inventions, Industrial Design No. 123/1995.

### Use of patents in licensed production

Licensed production is the authorized production (in Ethiopia) of a product using technology developed elsewhere. This involves obtaining permission from a company (licensor) to manufacture and sell its products. The company in Ethiopia that obtains these rights (the licensee) usually agrees to pay royalty fees to the owner or licensor (Haile, 2018).

For example, Lixil Corporation's SATO Division has established licensed manufacturing and distribution contracts with local (usually plastic) manufacturers in the region, including in Kenya and Tanzania. IP rights (patent protection) play a crucial role by protecting the licensor's technology, and also gives the licensee (local manufacturer) a market advantage.

In Ethiopia, Lixil's SATO Division has experienced some challenges licensing a local manufacturing company for production of the SATO pan. If a licensor does not have a valid Ethiopian manufacturing license, Ethiopian law does not permit the licensor to import and own a mold. Injection molds are the main capital investment required to start manufacturing plastic products. Therefore, a manufacturing licensee would purchase and import the mold, and would consequently fully own it. Such a transaction would be permanent, in other words it would not allow the licensor to subsequently change the local manufacturer by giving the mold to a new licensee if they felt this was required.

These licensing challenges can be avoided if an enterprise obtains an Ethiopian manufacturing license. Other options include establishing a joint venture with a local manufacturing company, possibly with specific contractual arrangements between the licensor and licensee, to mitigate the risks discussed above. However, the financial and administrative hurdles associated with these approaches may be

perceived as deterrents by potential investors, adding to the risk factors which could inhibit companies from exploring local manufacturing of new (WASH) products in Ethiopia.

### Product certification

Though currently not applicable to sanitation, other WASH products may be required to receive a seal of approval prior to use by the Ethiopian Food and Drug Authority (EFDA). Like the World Health Organization, EFDA rates household water treatment technologies as 3-star, 2-star, 1-star or "fail", based on the product's pathogen removal efficiency (i.e., bacteria, viruses, and protozoa).

Ethiopian-made household water treatment technologies require EFDA product safety certification. However, EFDA does not currently have a laboratory to test pathogen removal efficiency, and the agency has not authorized any other domestic laboratories for these tests. Also, there are no labs in the country that can conduct tests for viruses and protozoa removal, so these have to be conducted outside of Ethiopia.

There are Ethiopian labs that can test microbial efficiency, but these have not yet been authorized by EFDA. For example, a lab run by the Ethiopian Conformity Assessment Enterprise (supervised by the Ministry of Trade and Industry) is authorized by EFDA to conduct water quality testing for bottled water, but it has not been authorized to conduct similar tests for household water treatment technologies.

### 3.6. Business start-up requirements

Starting up a business in Ethiopia can require a significant up-front cash investment. A foreign company setting up on its own is required to deposit a minimum of \$200,000, and a joint venture between a foreign company and a local partner requires that

the foreign entity deposit \$150,000.<sup>16</sup> While these funds can later be spent once the business is established, the size of this initial deposit can present a significant hurdle for small to medium-sized investors, especially new businesses.

Another part of the start-up process requires Environmental and Social Impact Assessments be filed and approved, which reportedly can take up to several years.

In many countries, governments have created a separate classification for businesses that are created and designed to address a social problem. These are referred to as “social enterprises”<sup>17</sup> and can support the government in meeting economic growth, public health, and other societal objectives. The aim of a social enterprise is not to maximize profits (although they must generate enough profit to be self-sustaining) – but rather to achieve and increase social impact (Yunus, 2009).

The social enterprise classification typically confers tax incentives, streamlined registration processes, and other benefits. This allows such enterprises to combine the mission of a non-profit agency with the efficiency of a for-profit company.

In Ethiopia, a registered NGO can apply to the Agency for Civil Society Organizations (ACSO) to undertake an *income generating activity* (IGA), a form of social enterprise. This allows the IGA wing of the NGO, which operates as its own entity with separate accounts, offices, and staff, to generate income (revenues) from which the NGO can cover some costs while still receiving grants and donations. There are a number of requirements to meet in order to register an IGA, including that the NGO opens a separate bank account and keeps separate books for the IGA, which

must then be operated in accordance with applicable commercial and tax laws.<sup>18</sup>

A British Council's 2017 study of socially-oriented businesses in Ethiopia found that relatively few had chosen this classification – often eager to differentiate themselves from NGOs (British Council, 2017). The study found that most of these socially-inclined businesses either registered as a *micro or small enterprise* (MSE), or as a *sole proprietorship*. Table 1 below illustrates the findings.

The study also found that regardless of their legal registration, these businesses continued to regard themselves as *social enterprises*. (British Council, 2017)

Table 1: Legal status selected by businesses identifying themselves as “social enterprises” in Ethiopia (adapted from British Council, 2017)

Legal status selected	No. of respondents	Percent of respondents
Micro and small Enterprise (MSE)	41	31%
Sole proprietorship	30	22%
Cooperative	12	9%
Partnership	11	8%
Charity or society	9	7%
Limited partnership	8	6%
Private limited company	8	6%
NGO / non-profit	6	4%
NGO with income generating activity	5	4%
Share company	2	1%
Joint venture	2	1%
General partnership	0	0%
<b>Total</b>	<b>134</b>	

<sup>16</sup> Investment Proclamation No. 1180/2020.

<sup>17</sup> In the United Kingdom, these are called *community interest companies*, and in South Africa, *non-profit companies*.

<sup>18</sup> Organizations of Civil Societies Proclamation 1113/2019.

MSEs are an important element of the government's efforts to boost employment. Registration of MSEs is done through the Ministry of Urban Development and Construction and reportedly is fairly straightforward with low barriers to entry. However, there are limits to capital and human resources (e.g., a maximum of 30 employees for small enterprises).

If a socially minded business registers as a commercial company with the Ministry of Trade and Industry, that business will be in competition with mainstream for-profit companies and is subject to the same rigorous investment and tax regulations.

The Social Enterprise Ethiopia (SEE) organization, a relatively new network of social entrepreneurs, seeks to expand this sector of the Ethiopian economy. A key SEE focus is to achieve separate legal recognition for social enterprises in the country (Patton, 2018).

The use of a separate "social enterprise" business registration system has taken root in other countries to encourage start-up and expansion of organizations focused on assisting governments to achieve their social welfare targets. A similar classification approach in Ethiopia might help systematize and simplify the current registration situation and serve to expand the number and scale of organizations devoted to these objectives.

### **3.7. Business knowledge and skills**

Some investors raise concerns about limitations of the industrial infrastructure in the country and the general capacity of the manufacturing workforce. Businesses may feel they are in a bind; wanting to buy parts and components locally, but, due to limits of equipment, workforce capability, and other constraints, they resort to the cumbersome and costly import process.

Although entrepreneurs running businesses in Ethiopia recognize the challenge of an under-skilled workforce, many accept it as part of the mission of socially motivated industries. Their products as well as their business model seek to contribute constructively to the Ethiopian workforce and economy.

The government has recognized the importance of strengthening technical skills, investing in technical training institutes such as the Adama Technical University. However, additional steps will be required to ensure that needed machinery and equipment can be imported so that local manufacturing can more rapidly expand.

### **3.8. Manufacturing challenges and production choices**

Businesses in Ethiopia face a variety of challenges with respect to acquiring needed manufacturing inputs. It can take six to nine months to complete a material import process or to receive an order from a distributor. And after receiving a container of raw materials following a months-long process, the materials may get used up within the first month of production.

A consequence of this inefficiency is that manufacturers often choose to produce well-known products with strong existing demand (requiring little to no marketing), rather than take a risk on a new product line with unproven demand or profit margins (e.g., low-cost sanitation products).

There are other aspects of the imports process that can cause further complications. Some businesses reported that government classification of products to be imported can change from one round to the next, leading to increases in fees, delays from review and dispute resolution processes, and additional expenses such as demurrage (storage charges) accrued while disputes are being resolved. Some businesses reported requests for non-mandatory

certificates and additional stamps of approval, which further delayed the process and increased demurrage charges.

### 3.9. Financing for enterprises and businesses

The credit market for businesses offering sanitation and other WASH products and services is still quite new and under development. High commercial interest rates and uncertain consumer demand are key disincentives for potential borrowers. Private sector businesses in Ethiopia often mention the lack of access to affordable financing as one of their top challenges (Ahmed, 2019). The range of WASH businesses is quite broad and includes small-scale artisans manufacturing or installing latrine pans and slabs, retail shops selling household-oriented products, importers, wholesale distributors, and commercial manufacturing operations. There are several financing options available, depending on the type of business. For local enterprises, borrowing from Savings and Credit Cooperatives (SACCOs) or Microfinance Institutions (MFIs) are options. However, although such lenders are familiar with the agricultural sector, most know relatively little about WASH enterprises.

As borrowers, WASH businesses generally have a good repayment reputation, but evidence suggests that sanitation businesses can have problems with late payments – possibly due to the seasonality of their customers' income (Aboma, 2020).

Financial support for WASH businesses is offered by some NGOs, either for start-ups or to expand existing operations. Interventions may be in the form of dedicated programmatic funds, as well as in-kind support such as marketing and advocacy to build demand for products and services. Other NGOs have provided capital directly to MFIs for specific WASH loan products.

For larger-scale operations such as manufacturing, financing will likely need to be secured through commercial banks (or brought in by foreign joint-venture partners). Credit institutions may struggle with providing loans to a relatively new type of industry client.

A related problem is that investors may perceive these WASH products as high-risk, as they are being introduced in a relatively new and untested Ethiopian market. Some businesses have expressed a desire to have “demand guarantees” provided to them by government or development agencies – to ensure that at least a certain number of the products they produce (or import) will be purchased at a known price level.

It will require a concerted effort by government and support agencies to establish more widespread credit options for the emerging market for WASH products and services.

### 3.10. Financing for consumers

Affordability of WASH products and services remains a significant concern for many Ethiopian households and for the businesses that sell them. Income, especially for families involved in agriculture, tends to be seasonal.

There currently are a range of credit schemes and agencies that target low- to middle-income households. For example, *iqub* and *iddir* are home-grown mechanisms designed for infrequent or emergency expenditures, such as funerals or social celebrations. These mechanisms do not charge interest, but they have limited capital and would require adaptation and more capital to reach scale. Another popular local financing system is community-based health insurance, through which members make payments into a collective fund, which can be accessed to cover health care costs when a member falls ill.

Transform WASH has been working to establish Village Savings and Loan Associations (VSLAs) for household sanitation-related loans. The VSLA mechanism is a potentially viable consumer financing mechanism and has the advantage of also helping households save money. Scaling this up for large-scale sanitation financing would likely require much more supervision, training, and support.

Community-based initiatives, such as VSLAs, Savings and Internal Lending Communities (SILCs), and SACCOs offer the advantage of local credibility and relatively low interest or service charges. Evidence suggests that their sanitation loans have high repayment rates. However, these mechanisms require extensive training, management and supervisory systems which typically rely on NGO or other external resources for support.

Public and private MFIs are more professionally run with greater resources, but they tend to charge higher interest rates and be geographically limited to the highlands. Water.org has successfully worked with several MFIs to develop affordable household loans for WASH product purchases.<sup>19</sup> The loans have proven very popular - in less than one year, these MFIs disbursed loans totaling nearly ETB 19 million (\$560,000), reaching around 22,500 individuals. The loan repayment rate was 99.9% (Getnet, 2019).

WASH organizations working with banks and MFIs can now cite evidence from this successful microfinance effort to support their drive to increase the availability of suitable loan products. Yet financial institutions operating in the WASH sector acknowledge that there is still a lack of loanable funds from which WASH businesses can borrow.

MFIs and voluntary savings and loan schemes are generally unable to reach consumers at the lowest end of the economic spectrum. Since many of these households are also food-insecure, the Ministry of Agriculture established the "Productive Safety Net Program" (PSNP), which assists an estimated 8 million people (World Bank, 2017a). The Ministry of Health and development partners are advocating with the Ministry of Agriculture to explore options for including sanitation as part of the PSNP program as a way of reaching the very poor.<sup>20</sup>

Gender issues also come into play regarding uptake of WASH products and services, and financing. A study of cookstove purchases in northern Ethiopia found that women are far more interested and willing to pay for those products (Alem et al., 2018). Similarly, women are often responsible for household water and are often more conscious of water supply problems - and more willing to pay for improved services (Bogale et al., 2012). The burden of not having access to improved sanitation or adequate hygiene facilities also tends to be felt more by women (and girls). It may therefore be advantageous to tailor WASH loan products and financing drives towards female consumers.

FMOH also acknowledges the need for affordable household financing for WASH and is working with commercial lending institutions to establish a class of bank loans targeting household sanitation, similar to what was done to increase the availability of credit for fertilizer purchases.

There are a wide range of consumer credit mechanisms in Ethiopia, and with support from WASH sector agencies there are MFIs which are now strengthening their focus on WASH. However, there is still a large, unmet need in this area.

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<sup>19</sup> Metemamen, Vision Fund, and Specialized Financial and Promotional Institution.

<sup>20</sup> The fifth Productive Safety Net Program begins in 2021.



## 4. Conclusions and Recommendations

Private sector sanitation and other WASH enterprises in Ethiopia have made exciting inroads in the past several years. They have introduced new household sanitation, safe water, and hygiene products to consumers, as well as starting new businesses and expanded existing ones. In so doing, they have created more employment opportunities and helped move the country toward universal access to basic WASH services. However, the size of most of these operations is still relatively small compared to the scale of the challenge. Businesses still face a number of market hurdles that can limit the growth and profitability of their operations, and which increase pricing and reduce availability for consumers.

Some of the challenges facing the WASH market are more general and affect the entire economy, and although they are beyond the scope of this study, nevertheless they are important and worth mentioning:

- Unreliable power supplies
- Unstable and costly internet and mobile phone network service
- Security concerns and road closures in some areas
- Inflation and depreciation of the Ethiopian Birr.

Experience with Transform WASH and other market-focused projects has revealed several more specific issues that, if addressed, could help strengthen and expand the private sector WASH market in the country. These are summarized below, along with regulatory and policy actions which might help address the issues.

**Access to foreign exchange currency.** The relative scarcity of Forex in Ethiopia makes acquiring it for importing raw and finished materials one of the most important challenges for many WASH businesses.

### **Recommendations:**

- *Review foreign exchange operating guidelines and consider ways of making the application, queuing, and liquidation processes more accessible, accommodating and transparent.*
- *Encourage policy reforms that raise the priority of Forex access for socially oriented businesses in emerging markets such as WASH.*
- *Advocate for WASH products to be added to the list of “essential or priority goods,” so that Forex is more readily allocated to businesses importing or manufacturing WASH goods.*

**Taxes and tariffs.** Steep import tariffs and a range of domestic taxes can greatly increase the cost of sanitation and other critical WASH products. This will lower overall demand – and place additional economic burdens on poor households.

### **Recommendations:**

- *Complete ongoing research to understand the effects of lowering tariffs and taxes on sanitation products, including influence on consumer demand and on government revenues.<sup>21</sup>*
- *Review and revise classification of imported WASH products to ensure critical items can readily be imported.*
- *Review and revise import tariff and domestic tax rates and policies to ensure critical WASH products remain as affordable as possible.<sup>22</sup>*

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<sup>21</sup> Additional research has been planned by the Federal Ministry of Health and USAID Transform WASH to confirm the actual extent of this effect; however, it has been delayed by the 2020 COVID-19 pandemic response.

<sup>22</sup> This may require special attention to how VAT and withholding tax are applied, and whether small businesses are aware of the correct administrative processes related to these taxes.

**Encourage large-scale local production of key WASH products** through favorable start-up and related operating business regulatory reforms, to help encourage investment.

**Recommendations:**

- *Review Intellectual Property (IP) protection policies and enforcement mechanisms and enact reforms which encourage local manufacturing and introduction of new (patented) products to the Ethiopian market.*
- *Review importation policies for manufacturing equipment and reform (if needed) to simplify licensed production of WASH products in Ethiopia.*
- *Review (and reform as needed) start-up business investment requirements to encourage more rapid growth of sanitation and other WASH businesses, and to stimulate local manufacturing of products which currently are imported.*
- *Strengthen the “income-generating activity” mechanism for registered NGOs, including providing relevant tax, investment, and other forms of relief to encourage greater use of this option by WASH-focused organizations.*
- *Provide a “social enterprise” registration option for appropriately qualified (WASH) businesses (and provide associated tax, investment, and permitting relief) to encourage expansion of these services to the poor.*

**Limited options for affordable financing.** WASH businesses and consumers lack access to affordable loans – which is holding back both household and commercial investment.

**Recommendations:**

- *Establish a class or classes of WASH-focused loan products at commercial banks and MFIs – and set appropriate*

*service targets to accelerate the process.*

- *Review the range of household financing options and establish training, technical support, and capital financing programs to help scale up the most effective approaches.*
- *Encourage commercial and development banks to allocate dedicated capital for MFIs to establish loan products and programs tailored towards household WASH products and services.*
- *Advocate for the establishment of loan guarantee facilities that encourage financial institutions to provide WASH loans.*
- *Expand the PSNP or related poverty alleviation efforts to provide financial support or other incentives for economically-challenged households to acquire basic WASH services.*

**Address women’s needs in the WASH marketplace.** Women have strong, demonstrated interest in improved WASH services, and can play an influential role in the market.

**Recommendations:**

- *Encourage private sector actors and finance institutions to design products, services, and financing mechanisms that are tailored for women.*

**Increase Ethiopian product certification capacity.** Being able to test and certify WASH products such as water filters, water treatment chemicals, and others will eliminate the need to send such items out of the country for testing and should speed up the approval process.

**Recommendation:**

- *Support the establishment of efficient in-country WASH product testing and certification protocols and processes.<sup>23</sup>*

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<sup>23</sup> The primary agencies the work with include Ethiopian Food and Drug Authority and the Ministry of Trade and Industry.

### **Intellectual property rights and protection.**

Stronger IP protection, as well as longer protection periods, could help encourage certain investors to introduce or innovate new WASH products and services in Ethiopia. This type of reform also would encourage local manufacturing of essential WASH products.

#### **Recommendations:**

- *Encourage review of trademark and patent protection systems, and to make any needed reforms to ensure they are competitive both regionally and globally.*
- *Reforms might include issuing multi-year protections, ensuring joint-venture partners can retain certain IP protections, lengthening overall protection periods, and adequate enforcement.*

**Focus on existing entrepreneurs to expand the sanitation market.** Growth of the private sanitation market will likely be faster and more efficient if government encourages existing businesses to expand and add WASH products to their current portfolio, rather than trying to start new businesses from scratch. Strengthening the skill level of the workforce also will encourage investment.

#### **Recommendations:**

- *Review policies focused on encouraging unemployed youth to start sanitation businesses. Enact appropriate reforms and incentives to encourage existing businesses to expand into the sanitation/WASH marketplace.*

- *Promote within the private sector the national Open Defecation Free campaign and the business opportunities it presents.*
- *Tailor and expand vocational training efforts (such as TVET colleges) to focus on building critical skills for the growing WASH economy.*

**Address the perceived risk of uncertain demand** for WASH products and services. Uncertainties in consumer demand, and certain entry barriers for WASH enterprises has elevated the perception of risk among businesses and investors. This can be alleviated in part through “guaranteed demand” or an initial order placement for new products and services. The government and its partners should consider providing guarantees of purchase quantities and/or pricing levels to lower the start-up risks for local manufacturers or importers.

#### **Recommendations:**

- *Review experience and evidence regarding of demand guarantees in Ethiopia and the region and identify suitable approaches to address this concern.*
- *Establish effective business monitoring systems to track demand, sales, pricing, and other relevant data to help regulatory agencies to more effectively support and manage expansion of the WASH economy.*

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