Report Number : ICRR14537

IEG ICR Review
Independent Evaluation Group

1. Project Data:		**Date Posted :**	01/12/2015	
Country:	Ethiopia			
Project ID :	P050272		**Appraisal**	**Actual**
Project Name :	Ethiopia - Private Sector Development Capacity Building Project	**Project Costs (US$M):**	42.31	17.1
L/C Number:	C4027; CH141	**Loan/Credit (US$M):**	24	16
Sector Board :		**Cofinancing (US$M):**		
Cofinanciers :	IDA grant ($5m) Government of Ethiopia ($3m) and private local commercial sources ($15.31m).	**Board Approval Date :**		12/21/2004
		Closing Date :	06/30/2011	12/31/2012
Sector(s):	General industry and trade sector (60%); Central government administration (32%); Tertiary education (8%)			
Theme(s):	Export development and competitiveness (29% - P); State-owned enterprise restructuring and privatization (29% - P); Other financial and private sector development (14% - S); Micro; Small and Medium Enterprise support (14% - S); Regulation and competition policy (14% - S)			

Prepared by :	**Reviewed by :**	**ICR Review Coordinator :**	**Group:**
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2. Project Objectives and Components:

a. Objectives:

The Development Financing Agreement (DFA) states: "The objective of the Project is to facilitate increased participation of the private sector in the Borrower's economy by creating conditions for improving productivity and competitiveness of the said sector (page 23)." There is an equivalent statement in the Project Appraisal Document (PAD, page 9).

In a 2008 restructuring the objective was somewhat changed : "To facilitate increased participation of the private sector in the Borrower's economy by creating conditions for improving productivity and export competitiveness " (Amendment and Restatement of the DFA, page 26). The Restructuring Project Paper stated this somewhat differently: "to improve the enabling environment and institutional capacity for a sustained increase in private sector investment and exports (page 1)"

A 2012 restructuring goes back to the original formulation of the objective (Extension of Closing Date and Reallocation of Proceeds, Annex 2).

This Review will use the DFA formulations of the objective at appraisal, and as formally revised in 2008.

b.Were the project objectives/key associated outcome targets revised during implementation?

Yes

If yes, did the Board approve the revised objectives /key associated outcome targets?

Yes

Date of Board Approval: 04/01/2008

c. Components:

The project had three components.

1. Accelerating the privatization program ($9.87 million at approval, $6.33 million at closing per ICR Annex 1), including institutional capacity building of the Privatization And Public Enterprise Supervisory Authority, transaction advisory services, environmental audits, support to a retrenchment program, and impact assessments of privatized enterprises.

2. Improving the business environment through implementation of competition policy and World Trade Organization (WTO) accession ($1.1 million at approval, $0.82 million at closing).

3. Strengthening the international competitiveness of the private sector and the capacities of its representative organizations ($8 million at approval, $8.6 million at closing), including at appraisal building international competitiveness of private firms through a matching grant scheme that financed technical assistance, supporting an International Finance Corporation (IFC) initiative to improve business schools, and providing technical and financial assistance to small and medium enterprises. The following changes were made to this component at the first restructuring: the matching grant scheme was replaced by the Ethiopia Competitiveness Facility, including support for export plans for participating firms, addition of the United Nations' International Trade Center to provide market intelligence to new exporters, and revision of the Competition Policy, including the Proclamation, Commission, and its Secretariat.

d. Comments on Project Cost, Financing, Borrower Contribution, and Dates:

The project was approved on 12/21/2004, became effective on 07/15/2005, and was closed on 12/31/2012. It was initially funded by a credit of Special Drawing Rights (SDR) 12.7m and a grant for SDR 3.4m, which at approval was valued at US$24m.

The project was restructured in 2008, with the objective restated to emphasize export competitiveness, indicator targets adjusted, and the closing date extended to 31 July, 2012. US$4.39m had been disbursed at the time of this restructuring, or 27.4% of the total amount of IDA funds disbursed at completion (US$16m). Additional financing was requested, and a pre-appraisal mission carried out in 2011, but it wasn't approved due to problems over additional safeguard measures, and the delayed submission of a special audit report for the Voluntary Retrenchment Program. A second restructuring in 2012 further adjusted indicator targets, and extended the closing date to 31 December, 2012.

In addition to costs for the three components outlined above, the PAD provided for funds for implementation (US$1m), price contingencies (US$1.49m), and an unallocated amount (US$2.53m). Also, there is a provision for a local contribution, including US$2.4m in counterpart funding, and the remainder from private commercial sources (US$15.91m). The latter is notionally allocated to components one and three (PAD, Annex 5). The April 2008 restructuring reduced IDA's credit for the project from $19 million to $13 million, and the IDA grant from $5 million to $3 million. The reason was to reallocate funds to an emergency operation: Global Food Crisis Response Program, and the judgment that despite the substantial reduction, the PDO was still considered achievable. The local private financing contribution never materialized, and the Government counterpart contribution became $ 1.1 million (ICR, Annex 1). The ICR states that counterpart contribution was timely, but does not explain the reason for reduction in financing. The project benefited from appreciation of the SDR against the US$ that increased the dollar equivalent of the disbursements. The difference between appraised and actual component costs is because of the reallocation of funds to the emergency operation discussed above, and because remaining funds were reallocated to the better performing component.

3. Relevance of Objectives & Design:

a. Relevance of Objectives:

Before and After Restructuring: **High**

Both objectives are aligned with the Government's Growth and Transformation Plan (2010/11 – 2014/15) with its emphasis on achieving a competitive financial system and exchange rate, improving the quality of exports, providing selected incentives to the manufacturing export sector, and maintaining a sustainable fiscal balance so as not to crowd out private sector borrowing. They are also aligned with a key dimension of the Bank's Country Partnership Strategy (FY2013-FY2016) to support increased productivity and competitiveness of the industrial and services sectors for rapid and sustained job creation. The objectives are also highly relevant to country conditions. Ethiopia's low rating in cross-national surveys such as Doing Business 2014 (ranked 166 out of 189 countries surveyed) suggests the urgency of improving business conditions for enhanced productivity and competitiveness.

b. Relevance of Design:

Before: : **Modest;** and after restructuring: **Substantial**

There is a clear statement of the objective at appraisal, but the causal chain between funding, components, and intended outcomes had shortcomings. For example, the results chain was designed assuming that policies, laws and institutions were adequate for achieving expected outcomes just with the development of implementing regulations and enhancement of staff capacity. The experience of other comparable countries shows that much deeper changes would be needed. *Inter alia*, there was a need for new institutions to help Ethiopian firms better understand and take advantage of market requirements and reduce bottlenecks.

After restructuring, there is a clear statement of the objective, and a convincing causal chain between funding, components, and intended outcomes, with many of the shortcomings at appraisal addressed. New institutions were added such as the autonomous Ethiopia Competitiveness Facility, replacing the role of the Business Management Unit with new provisions for tapping market knowledge such as a new link with the United Nations International Trade Center. Competition policy would now be revised, along with its supporting legislation and institutional home. The new focus on exports helped to make efforts to improve competitiveness more specific. The broad based support to privatization at appraisal with its shortcomings evolved into reduced and more targeted support for specific industrial sectors, with additional complementary work covering the broader issues supported by the African Development Bank and the United Kingdom Department of International Development (DFID). The design could have been improved by considering alternatives to improve the performance of state owned enterprises (SOEs) such as political and administrative reforms.

4. Achievement of Objectives (Efficacy):

Original objective: to facilitate increased participation of the private sector in the Borrower's economy by creating conditions for improving productivity and competitiveness of the said sector

1. **To facilitate increased participation of the private sector** . **Substantial** The operation supported this through privatization of SOEs, the matching grants scheme, institutional capacity building of the Privatization And Public Enterprise Supervisory Authority, transaction advisory services, environmental audits, support to a retrenchment program, impact assessments of privatized enterprises, and business plan competitions for supporting startups. Three project development objective (PDO) targets were set to measure achievement. One of these—jobs created in the private sector in participating firms and sectors—was exceeded (target 4,500 jobs; actual achievement 5,719 jobs). The other two: increased value added per worker and increased private investment to GDP ratio were not measured because of difficulties both in measurement, and in attributing the results to the operation. However, as a proxy for the value-added per worker measure, the United Kingdom's Department for International Development's (DfID) 2012 impact assessment of the Ethiopia Competitiveness Facility (ECF). looked at a reasonable sample of supported firms that were able to quantify both turnover and employment, and the proportion that could be attributed to the ECF. Based on these figures, there was an 18% increase in labor productivity in participating firms as a result of ECF support, as measured by the average output per capita, close to the target of 20%.

In addition, the intermediate outcome targets of SOE assets transferred to the private sector (target 55%, actual achievement 77 %) was exceeded. The privatized firms that are profitable have started increasing the number of their employees. The target on number of startups set up as a result of business plan competitions was exceeded (original target 40, actual achieved target 52), and the target of such startups that were in business after one year of operation was exceeded (target 70%, actual achievement 77%). However, large SOE investments and other public sector borrowing continues to constrain credit for the private sector (IMF Article IV Consultation, 2014) The VRP was not fully utilized because the actual number of employees laid off from the privatization was lower than originally anticipated as most were retained by the privatized enterprises, and the design had overestimated the age of the employees who would take early retirement leading to an overestimation of the liability for pension contributions.

Finally, although not a target tracked by the operation, the private investment to GDP ratio has been measured by the IMF, and based on their estimate there was an initial decline in private investment as a percent of GDP between 2004/5 (7.6%) and 2007-8 (6.3%), an increase up to 2011/12 (8.1%), and projections for further increases in the medium term (IMF Article IV Consultations, 2008 and 2012). While the overall increase was the result of many factors (See Section 10a below), the work supported by the project may have contributed to this result.

2. **Creating conditions for improving productivity . Substantial .** The operation supported this through the matching grant scheme, and university capacity building. The privatization discussed above was also expected to improve productivity. The matching grant scheme and its successor ECF were judged to be successful by the DfID study referenced above. Beneficiaries of the grants have improved productivity, and the productivity increase are expected to be long lasting, based on skill improvement supported by training, better processes, and improved machinery . The revised curricula for MBA and MSc students in accounting and finance is expected to lead to more capable middle managers, particularly in the larger scale firms where such individuals tend to work .

Revised Objective: To facilitate increased participation of the private sector in the Borrower's economy by creating conditions for improving productivity and export competitiveness .

Before restructuring

3a. **Creating conditions for enhanced competitiveness . Modest**. The operation supported this through the matching grant scheme, university capacity building, and privatization . The expected boost to competitiveness from privatization was achieved, but the other relevant support was delayed prior to restructuring, so that any improvement in competitiveness due to this other support was limited

An assessment of achievement of this sub-objective based on cross-national survey data is inconclusive. By one measure, Ethiopia's Global Competitiveness index rating has improved from 2.93 on a 7 point scale in 2004 (lowest 101 out of 104 countries) to 3.60 (118 out of 144 countries) in 2014. By another measure, looking at Doing Business Survey data for Ethiopia going back to 2004, there have been only minor changes, indicating little evidence that overall competitiveness has improved. One of the few positive signs is the time needed to start a business, which has reportedly been reduced from 46 days in 2004 to 15 days in 2014. Most of the change took place before 2007, when the time was reduced from 46 to 18 days. However, there is no evidence that this improvement can be attributed to the pre-restructuring phase of the operation.

After Restructuring:

3b. Creating conditions for enhanced export competitiveness . Substantial . The fourth PDO target, measuring increase in exports, was exceeded (target 25% and/or 10 firms starting to export; actual achievement 29% and 20 firms). There were other factors beyond those supported by the operation that may have contributed to this result, such as the periodic devaluation of the exchange rate . Partially correcting the exchange rate misalignment may have contributed to raised exports, but IMF reports suggest that a premium over the official exchange rate remains large and persistent.

Other targets for enacting a revised competition policy, establishing an independent competition authority, completing WTO accession studies, and revising university curricula were achieved . Although the privatization actually achieved may have increased competition, one would need to know more, such as who the buyers were (e.g. domestic, foreign, incumbent managers, politically connected) to know the extent of the likely contribution to improvement.

5. Efficiency:

Modest

The ICR states that it could not replicate the ERR calculation at appraisal and does not report an ex post rate of return. The 2012 DFID evaluation of the Ethiopia Competitiveness Facility found a net present value of US$ 29.5 million, which exceeded the original estimate for the entire project of $US 22.6 million. The efficiency gains from other project components are unknown.

The project was restructured twice, in 2008 (almost three years after effectiveness of the project and in 2012 after 4 years of the first restructuring). While early restructuring may have helped make earlier adjustments to the implementation arrangements, the main objective of the restructuring in 2008 was to redefine the project interventions to focus on exports. Disbursements were subject to delay before the project was restructured, but accelerated afterwards.

There were VRP overpayments for reasons discussed in Section 4, and they were refunded. However, the project's failure to submit a Special Audit Report by the agreed deadline was a factor that prevented the request for additional financing to go through. The additional financing could have helped to expand project interventions and increase its impact to the private sector. The project supported capacity building and hands on support by Bank technical staff on procurement. A key constraint was that the procurement specialist hired for the project had resigned, and was not replaced until the end of the project. Given that four implementing agencies were carrying out procurements, the result was monitoring and coordination challenge in procurement and contracts management, including two contract disputes.

a. If available, enter the Economic Rate of Return (ERR)/Financial Rate of Return (FRR) at appraisal and the re-estimated value at evaluation :

	Rate Available?	Point Value	Coverage/Scope*
Appraisal	Yes	27%	100%
ICR estimate	No		

* Refers to percent of total project cost for which ERR/FRR was calculated.

6. Outcome:

Before restructuring, the objectives were highly relevant, but design was modestly relevant due to the need for deeper changes in the institutional support framework, operational issues, and lack of safeguards on privatization processes. Two sub-objectives prior to restructuring are rated substantial, and one modest, as operational difficulties and exogenous factors limited competitiveness improvements that could be attributed to the project . Based on these factors, IEG rates outcome before restructuring as Moderately Satisfactory . Design and Efficacy after restructuring were substantially relevant and substantial respectively, as most of the concerns and constraints prior to restructuring were addressed. Efficiency was modest due to a delay in the Special Audit Report, and shortcomings in procurement. Based on these factors, IEG rates outcome after restructuring as moderately satisfactory . The overall rating takes these ratings and the comparative share of disbursements into account : 26% of disbursements took place before restructuring, and 73% took place after restructuring. The outcome rating of Moderately Satisfactory (4 on a 6 point scale) prior to and after restructuring becomes an overall rating of Moderately Satisfactory (4*0.26+4*0.73=3.96, which is rounded to 4).

a. Outcome Rating : Moderately Satisfactory

7. Rationale for Risk to Development Outcome Rating:

The ICR points out many elements that should reduce risk : privatized firms are operational, with some recording profits; DFID will continue to finance the matching grant scheme; the Government will continue to finance future privatizations; and, the benefits of training will remain even if staff who were trained move to different jobs .

However, successful privatization is more likely with a growing and well managed economy . If large SOE investments and other public sector borrowing persist, they will continue to constrain credit for the private sector . Likewise, limits on private banking operations, directed lending, and allocation of foreign exchange to priority sectors by the government further increases risk. On balance, while commendable steps have been taken to mitigate risk, additional measures are called for in the years ahead.

a. Risk to Development Outcome Rating : Moderate

8. Assessment of Bank Performance:

a. Quality at entry:

The project was begun after considerable sector work that informed its design . The ICR notes the importance of timely advice to the government on project restructuring, but the undisbursed funds that prompted the restructuring partly reflected shortcomings in project design . Privatization was particularly important, considering the dominance of state owned enterprises; but greater attention could have been given to who buys the firms . The sale to those beholden to the controlling party and politicians would not necessarily achieve the objective; but the PAD is silent about what safeguards were in place (if any) to prevent such practice. Overstaffing was recognized to be an issue, and support for privatization included funding environmental audits and a Voluntary Retrenchment Program (VRP), but the design of the latter was overly complex.

In addition, more attention could have been given to the role of a competitive exchange rate (so important for exports), in addition to issues like anti-monopoly laws. Some of the project's original indicators had shortcomings, and although revised when the project was restructured in 2008, could have been better aligned to the objectives that were sought. Finally, the challenges that emerged in 2005-6 (see below) could have better addressed with more extensive contingency planning built into the design . While the specific events that transpired couldn 't have been predicted at appraisal, the election timetable was known in advance, and the risks associated with it could have been better anticipated and planned for .

Quality-at-Entry Rating : Moderately Satisfactory

b. Quality of supervision:

There were operational issues that emerged during supervision . For example, the Business Management Unit within the Ministry of Industry and Trade did not become effective, and led to delays in implementation . These and other shortcomings contributed to weak disbursement . Exogenous factors such as post-election violence in 2005 and 2006 added to the difficulties, for example with the closing of Addis Ababa University 's Faculty of Business and Economics for substantial periods . The Bank's Poverty Reduction Strategy Credit was also suspended in 2005, ending an important mechanism for policy dialogue . Supervision was adequate and regular (at least twice a year) in responding to these challenges . The reports flagged issues that arose, and these were corrected, despite the challenge of handing off responsibility to four different task team leaders . PDOs were made more specific and monitorable during restructuring . Delays in the VRP audit contributed to the failure of efforts to raise additional financing. It is not clear why in the second restructuring, the objective seemingly reverted to the original formulation.

Quality of Supervision Rating : Moderately Satisfactory

Overall Bank Performance Rating : Moderately Satisfactory

9. Assessment of Borrower Performance:

a. Government Performance:

Government counterparts did what they agreed to do in terms of managing the operation, The State Minister of the Ministry of Industry was involved in daily oversight, in assigning an experienced management team, and in ensuring the strong engagement of the steering committee that included key representatives of the private sector . The Ministry of Finance and Economic Development provided necessary counterpart funding, and was pragmatic in managing reallocation of funds. However, a moderate shortcoming is that there continue to be policy constraints on private banking operations and allocation of low interest loans and foreign exchange to government priority sectors. These practices constrain increased private sector investment in the country .

Government Performance Rating Moderately Satisfactory

b. Implementing Agency Performance:

The Coordination Unit was led by an experienced senior staff for the project duration . The ICR reports that implementing agencies performed unevenly (page 41) resulting in some component two activities not being completed, and available funds not being fully used . The delay in replacing the procurement specialist contributed to delays and shortcomings in procurement and contract management . Financial and project reports were submitted in a timely manner, and without major shortcomings except for the audit of the VRP that was delayed.

Implementing Agency Performance Rating : Moderately Satisfactory

Overall Borrower Performance Rating : Moderately Satisfactory

10. M&E Design, Implementation, & Utilization:

a. M&E Design:

The PAD includes an elaborate Results Framework and Monitoring, and most indicators were specific, measurable, attributable and relevant. However, there were exceptions. For example, one indicator at appraisal was "Increased private investment to GDP ratio from 10.5 percent in 2003/4 to 15 percent in 2009" (PAD, Annex 3). This was problematic because: (i) GDP falls during droughts raising the ratio, (ii) farm investment is also private but the project is not directed to this, making attribution problematic, and (iii) the indicator couldn't be correctly measured. Another indicator at appraisal, measuring value added per worker, also could not be correctly measured .

While it is difficult to measure improved business climate or increased competition, the project's indicators could have been enhanced. Employment in or exports by participating firms are not adjusted for other factors that influence them. Nevertheless, there was a good design to monitor assets that were being divested .

b. M&E Implementation:

Good effort was made to collect and use the monitoring indicators, and the two revisions to the indicators (in April 2008 and July 2012) reflect this effort. Some indicators were revised because they proved to be difficult to measure . Project objective was revised to align with the Government's shift to focus to exports . The second restructuring ensured better alignment with the Government's new Growth and Transformation Plan emphasis on manufacturing industry. An impact assessment commissioned by DFID provided timely evidence on progress of the ECF .

c. M&E Utilization:

In the two restructurings, resources were reallocated to the best performing components, based in part on utilizing monitoring information.

M&E Quality Rating : Substantial

11. Other Issues

a. Safeguards:

The project was "category B" for environmental aspects because several of the enterprises being privatized were polluters. Environmental audits were financed and conducted, but the project does not describe (even with an example) the nature of the pollution and whether it merely ceased or whether past pollution was (or could be) remedied. Bank staff seem to have relied entirely on consultants hired to provide an audit, but the ICR makes no reference to any follow through.

b. Fiduciary Compliance:

Financial management was generally good from all accounts in the ICR and ISRs . A delayed special audit of the VRP found overpayments of US$1.6m that were refunded to the designated account. The reasons for the overpayment were some wrong assumptions made during the estimation of the budget which resulted in excess funds released to the Social Security Agency . There were two contract disputes during project implementation, and other shortcomings in contract administration.

c. Unintended Impacts (positive or negative):

None noted in the ICR.

d. Other:

12. Ratings:	ICR	IEG Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	Modest efficiency due to delays in audit and procurement limitations.
Risk to Development Outcome:	Negligible to Low	Moderate	Exchange rate misalignment and the risk of political decisions that favor particular regions and groups increase the possibility of a reversal of key achievements. If large public sector borrowing persists, it will continue to constrain credit for the private sector.
Bank Performance :	Moderately Satisfactory	Moderately Satisfactory	
Borrower Performance :	Moderately Satisfactory	Moderately Satisfactory	
Quality of ICR :		Satisfactory	

NOTES:
- When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
- The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

13. Lessons:

IEG supports the thrust of the “lessons learned” section in the ICR, which includes both findings and lessons.

Private sector development operations are most effective when inclusive of key stakeholders from both public and private sectors. Contingency plans can help to address known externalities such as elections, while being flexible enough to respond to new and unexpected policy priorities.

A multifaceted approach can be effective in promoting export competitiveness including, *inter alia*, consideration of a competitive foreign exchange rate.

14. Assessment Recommended? ○ Yes ● No

15. Comments on Quality of ICR:

Minor flaws detracted from an otherwise frank and well written ICR: the multiplicity of acronyms that were not spelt out either in the text or the key, and numbers that did not add up (e.g. project costs and financing in Annex 1). General macro-economic aspects (e.g. GDP growth, exchange rate valuation) that may have affected employment and exports were not adequately acknowledged either in the ICR or in the original project document. Also, the ICR should have done a split evaluation, as has been done in this review, because of the change in project objective during the 2008 restructuring. Finally, the ICR should have provided data on the contribution of the ECF to improved labor productivity in supported firms, drawing from the DfID impact assessment.

a.Quality of ICR Rating : Satisfactory