Ministry of Finance

A Technical Note to Guide the Creation of a Fund to Support a Digital Startup Ecosystem in Ethiopia

Digital Financial

in partnership with

Digital Pathways, Blavatnik School of Government, University of Oxford

September 2021

Authors: Alexander Munro, Digital Financial
Walid Ahmed, Digital Financial
Lisa Skinner, Digital Financial

Editor: Sarah Edmonds, Digital Financial

Research: Don Harpell, Digital Financial
Pieter Janse van Vuuren, Cenfri
Sasha Lünsche, Cenfri

Acknowledgements

Digital Financial and Cenfri would like to acknowledge the guidance and assistance of:

- Hinjat Shamil, Ministry of Finance, Ethiopia
- Myriam Said, Office of the Prime Minister of Ethiopia
- John Owens, LLB, Digital Finance Advisory Services
- Matthew Sharp, Digital Pathways, Blavatnik School of Government, University of Oxford
- Our colleagues at development agencies and successful startup investment hubs, who offered us vital guidance and challenged our assumptions.
- All the stakeholders, public and private, who participated in our qualitative study. Their candid engagement and feedback were invaluable.

Table of Contents

Table of Figures

Table of Tables

Abbreviations & Acronyms

AfDB	African Development Bank
agritech	Agriculture Technology
BMGF	Bill and Melinda Gates Foundation
COVID-19	Coronavirus Disease 2019
edtech	Education Technology
EIC	Ethiopian Investment Commission
EoDB	Ease of Doing Business
FDI	Foreign Direct Investment
FDRE	Federal Democratic Republic of Ethiopia
FoF	Fund of Funds
fintech	Financial Technology
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GoT	Government of Tunisia
GSMA	Global System for Mobile Communications /(Association)
healthtech	Health Technology
ICT	Information and Communication Technology
IFC	International Finance Corporation
IMF	International Monetary Fund
IPO	Initial Public Offering
JCC	Jobs Creation Commission
MInT	Ministry of Innovation & Technology
MoF	Ministry of Finance
MSME	Micro, Small & Medium Enterprises
NBE	National Bank of Ethiopia
NGO	Non-Governmental Organisation
ROSCA	Rotating Credit and Savings Association
SAOE	Semi-Autonomous Operating Entity
SME	Small and Medium Enterprise(s)
SSA	Sub-Saharan Africa(n)
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
VC	Venture Capital
VC FoF	Venture Capital Fund of Funds
VCTF	Venture Capital Trust Fund (Ghana)

Table 1 Abbreviations and Acronyms

Executive Summary

Across the globe, entrepreneurship is recognised as a powerful transformative force. About 90% of the world's companies fall under the heading of small and medium-sized enterprises (SMEs), and these in turn employ half the world's workers.[1] Truly innovative small and medium businesses can have a dramatic effect on their home economies: stimulating job growth, enhancing productivity, and attracting foreign investment. Research shows that such standout pioneers tend to thrive in jurisdictions that make a conscious effort to nurture them through, among other measures, targeted government policies, novel support models, and innovative financial systems.

In June 2020, the Federal Government of Ethiopia launched its Digital Ethiopia 2025 Strategy, an initiative designed to nourish and transform the country's digital sphere and to leverage technology and entrepreneurial spirit to build a more prosperous society. Top-down efforts, some of which are outlined in this report, have already advanced connectivity and accessibility at the network level and have begun to create a more welcoming environment for foreign investment. The fostering of a digital startup sector that will leverage these positive changes to drive economic growth is a logical next step.

A startup-friendly culture has the potential to deliver significant benefits for Ethiopia. These may include:

- the development of entrepreneurial skills,
- the expansion of the private sector's role in driving economic growth,
- productivity improvements across existing industries and traditional sectors, through the trial-and-error testing of new business models and the development of new technological applications, and
- an acceleration in the advancement of the digital economy.

Most importantly, startups create employment opportunities for both experienced, business-savvy workers and younger people who are often very open to new technologies and ways of problem-solving. This is particularly important for Ethiopia, as the median worker age is just 19.5 years[2] and the workforce is expected grow by approximately two million new entrants each year for the next decade.[3]

[1] "World Bank SME Finance: Development News, Research, Data," World Bank, accessed October 3, 2021, https://www.worldbank.org/en/topic/smefinance.

[2] Ethiopia - The World Factbook," Central Intelligence Agency (Central Intelligence Agency, November 16, 2021), https://www.cia.gov/the-world-factbook/countries/ethiopia/#people-and-society.

[3] Lauren Kelly and José Carbajo Martinez, "Can Ethiopia Create 2 Million Jobs Every Year?," Independent Evaluation Group (World Bank Group, September 4, 2018), https://ieg.worldbankgroup.org/blog/can-ethiopia-create-2-million-jobs-every-year.

In support of this vital effort, the Ministry of Finance (MoF) of Ethiopia and its development partner, Digital Pathways, Blavatnik School of Government, University of Oxford, have commissioned this Technical Note to Guide the Creation of a Fund to Support a Digital Startup Ecosystem ("Note"). The primary purpose of the Note is to assist the Ministry of Finance in the design of a robust fund structure that would provide financial assistance for digital startups in line with government strategies and policies, factoring in global best practices, successful precedents in comparable countries, and key national economic objectives.

1.1 Goals and structure of this Technical Note

The Note originally set out to:

- assess, through research and interviews, the current landscape for startups in Ethiopia, identify strengths and roadblocks, and determine how Ethiopia could best increase access to international investment capital for digital firms.
- evaluate and make recommendations on the structures and instruments for financial support that would both meet global best practices and fulfil the specific needs of Ethiopia, including direction on governance and capitalisation measures.
- match key digital sectors (i.e., fintechs, agritech, healthtech, etc.) and startup phases with appropriate funding sources. This mapping exercise was modified to focus on developing an ecosystem approach when discussions with entrepreneurs and investors, as well as research into successful startup support programs in developing economies, revealed potential difficulties with an overly targeted funding scheme.

This Note begins with a brief overview of the economic and infrastructure challenges which are being addressed by the Government of Ethiopia at it strives to build a digital economy (Section 2 and Section 3). This is followed, in Section 4 by a discussion of the barriers to startup success which were identified during detailed interviews with stakeholders from across the ecosystem including: startup founders, the leadership of incubators/accelerators, the investment community, development institutions and public sector stakeholders. The primary challenge identified by both the stakeholder interviews and extensive research, was the lack of access to finance, which is explored in Section 5. Section 6 presents recommendations for the creation of a framework of funding and organisations to be managed and operated by a semi-autonomous operating entity (SAOE). This framework includes an Investments Unit, an ecosystem development group (Ecosystem Unit) and a Marketing Unit. This section includes an exploration of the capitalisation requirements, fund life cycles, and potential funding partners. A detailed case study of the highly regarded Smart Capital Tunisia program follows in Section 7. Annex 1 presents recommendations on the implementation of the currently proposed Startup Act, which would be the foundational piece of legislation to support startups. These reflect the knowledge gained from the interviews, research, and the consultants'

experience with schemes to develop a fertile environment for startups in other developing economies.

1.2 Summary of Key Recommendations

Ethiopia's primary goals behind nurturing a healthy and thriving startup sector are attracting foreign direct investment and leveraging it to create jobs and build a digital economy through the development of innovative digital products and services. The recommendations therefore promote policies, investment structures and governance models which would be acceptable to traditional for-profit venture financiers, impact investors and development agencies while also addressing the concerns raised in the stakeholder engagements.

1.2.1 Recommendations for the "Jumpstart Ethiopia" SAOE Framework

This Note strongly recommends that the Government of Ethiopia establishes **a comprehensive framework of funding and support programs managed by a semi-autonomous operating entity (SAOE) which is governed by a board which incorporates both public and private sector stakeholders. This board could report to the proposed National Startup Council or to the Ministry of Innovation and Technology and should also be under the financial supervision of the Federal Auditor General.** Similar models have delivered strong results in India and Pakistan (Section 6.1.6) and have found favour with development institutions. A detailed case study of Smart Capital Tunisia, which is a comparable structure and operating entity sponsored by World Bank, is provided in Section 7 of this Note. One of the advantages of having a managing and operating entity which is at arms-length from the government, is that it helps to overcome the reluctance of international investors to participate in economies where they would otherwise have concerns around undue influence by powerful public sector actors. Conversely, some distance from the staffing, funding and investing decisions protects the government from allegations of favouritism and from reputational risk if unwise choices lead to disappointing results. In short, this Note supports a structural approach which establishes a separation between policy creators and policy implementors so that the startup ecosystem is supported by the Government but not directed or controlled by the Government.

The recommended framework does not include funding which is targeted to specific sectors (e.g., agritech, fintech), as this tends to distort investment in a nascent startup market and, in the worst case, discourage innovation as entrepreneurs, incubators and accelerators focus on the sectors that have the most immediately available funding, rather than responding to opportunities for sustainable, market-driven growth. Once the ecosystem becomes more mature and for-profit international financiers have assumed a greater role than public sector and other not-for-profit investors, targeted interventions would be less likely to cause market distortions. However, even highly developed startup ecosystems, such as Singapore, have created inefficiencies through a sectorial approach

which has led to a significant number of startups failing to exit from the support funding.[4] On these grounds, this Note strongly recommends that the "Jumpstart Ethiopia" framework should fairly and equitably support all the categories of enterprises targeted in the proposed Startup Act. Specialised initiatives aimed at leveling the startup playing field for disadvantaged groups, such as women, minorities, the disabled, and rural persons, rather than promoting specific sectors, will encourage diversity among entrepreneurs and the market-appropriate businesses they will create.

The recommended "Jumpstart Ethiopia" SAOE would have four distinct divisions: an Investment Unit, divided into a Priority Investment Sub-Unit and a Secondary Investment Sub-Unit; an Ecosystem Unit; and a Marketing Unit. The **Priority Investment Sub-Unit** would establish and manage a substantial Venture Capital Fund of Funds (VC FoF) for broad investment in Ethiopian digital startups and a smaller co-investment fund to leverage investor interest in exceptional startup opportunities. It is recommended that these funds are initially capitalised on a concessional basis by the Government and its development partners. This unit should be staffed at the decision-making levels with the best available talent, who should be contractually obligated to mentor Ethiopian investment professionals. The details of the Priority Investment funds are described in Section 6.2.1.

The **Secondary Investment Sub-Unit** (Section 6.2.2) should have a mandate to implement and operate a selection of smaller funds, some of which were planned for in the Startup Act, that would support the startup ecosystem and help to quickly address barriers to success. These smaller funds would include: a Tech Credits Fund; a Tax Refunds Fund; an Innovation Challenge Fund; a Credit Loss Guarantee Fund; an Incubation Fund and a Matching Grants Fund. These smaller, locally domiciled, high-impact funds are the ideal vehicles to build domestic investment capacity through the employment and mentoring of Ethiopian investment professionals who may not yet have the experience to invest internationally.

The **Ecosystem Unit** (Section 6.3) is responsible for identifying and championing policy interventions, facilitating startup support, and creating a sense of community among the founders and staff of startups, innovative businesses and ecosystem enablers such as incubators and accelerators. The Ecosystem Unit will play a strategic role in matching individual startups to the best support and funding for which they qualify. This matching function is very important in an immature ecosystem such as Ethiopia, where various unrelated programs, sponsored by a variety of donors and impact investors, are supporting specific sectors (such as agritech) or types of entrepreneurs (such as women). This unit is also responsible for creating a forum for the discussion of policy and regulatory issues and for advocating for the needs of startups with government at the state and federal levels. The third major role of the unit is to support domestic, regional, and international

[4] Toni Eliasz, Jamil Wyne, and Sarah Lenoble, "The Evolution and State of Singapore's Start-up Ecosystem," Open Knowledge Repository (World Bank, March 1, 2021), https://openknowledge.worldbank.org/handle/10986/35328.

incubators and accelerators operating in Ethiopia using its local staff and knowledge and financing from the Incubation Fund. It is recommended that the Ecosystem Unit is governed, managed and funded via the SAOE, even though the current policy in Ethiopia has a similar group within MInT, to allow it to connect startups to funding and represent their concerns without the danger of conflicts of interest.

The **Marketing Unit** is responsible for promoting the investment potential of the startup ecosystem and outstanding individual startups to foreign and domestic for-profit investors through managing in-country events, sponsoring attendance at international competitions and creating and running advertisement campaigns. The unit is also responsible for maintaining alignment between Jumpstart Ethiopia (SAOE) and donor institutions and impact-focused investors. It is important for the reputation and sustainability of the Ethiopian investment environment that this unit champions collaborative and transparent processes and procedures when raising investments.

Through the implementation of the recommendations of this Note, the Government of Ethiopia will be able to leverage the policy reforms which it has undertaken in the past three years in combination with a foundational monetary investment to create a strong environment for the venture capital and technology-driven companies that can spur direct and indirect job creation, increase productivity and boost the development of a strong, entrepreneurial digital economy.[5]

1.2.2 Recommendations on the Startup Act

The Startup Act (Act), which is currently in the legislative process, will become the foundational document for Ethiopia's support for digital startups. This Note recommends a range of modifications and enhancements to the Act to ensure its long-term applicability and adherence to global best practices which could be put in place via a set of regulations and policies that spell out the implementation details of the Act. Most importantly, it is recommended that the Act ensures a level of separation between the Ministry of Innovation and Technology, which is responsible for the creation of a structure to support the startup ecosystem, and the organisation which will be managing and operating the investment funds and programs. The rationale behind this recommendation is discussed in the next section of this summary. It is strongly suggested that the act be implemented in a manner which ensures the formation of separately constituted and managed funds for specific purposes such as credit guarantees, retirement and health incentives and "Startup Scholarships". These separate structures would allow for program specific life cycles and

[5] Annalisa Croce, Jose Martí, and Carmelo Reverte, "The Role of Private versus Governmental Venture Capital in Fostering Job Creation during the Crisis," *Small Business Economics* 53, no. 4 (June 2018): pp. 879-900, https://doi.org/10.1007/s11187-018-0108-3.

Peter Fisher, "State Venture Capital Funds as an Economic Development Strategy," *Journal of the American Planning Association* 54, no. 2 (1988): pp. 166-177, https://doi.org/10.1080/01944368808976471.

allow the priority venture capital investment fund to reinvest or pay out its profits according to its own mandate. Further specific suggestions are detailed in Annex 1.

1 Methodology

1.1 Research

The research team, led by the Centre for Financial Regulation and Inclusion (Cenfri), engaged in an extensive review of the available data pertaining to the startup landscape in Ethiopia to gain an understanding of the ease of doing business, issues arising from startup policy, and barriers to finance and investment capital for new businesses.

1.2 Qualitative Study of Ethiopian Stakeholders

Four survey questionnaires based on the findings of the research segment of this initiative were created by the lead consultants. These were used as guides to conduct wide-ranging virtual discussions with a client-vetted selection of ecosystem stakeholders, including government personnel, members of the investment community, and entrepreneurs, along with ecosystem associations, incubators, and accelerators.

The consultations followed best practices for the protection and privacy of respondents, and the subsequent coding of thematic results. After the interviews were transcribed, the transcripts were thoroughly assessed and analysed to extract recurring themes.

1.3 Informal Engagement with Investment Funds & Development Agencies

To gauge external expectations related to the future of the Ethiopian market and its potential for producing investible opportunities from a blended finance perspective, the consultants leveraged insights from colleagues in a variety of international development agencies and foundations, including USAID Ethiopia, FSD Africa, IFC, MasterCard Foundation and UNCDF. The consultants also had ad-hoc discussions with for-profit investors who either had direct experience with the region or had successfully invested in exportable Ethiopian sectors (e.g., manufacturing, but not real estate). This research yielded useful and externally benchmarked perspectives on the Ethiopian market's strengths and weaknesses for both for direct investment and for alternative investment vehicles.

Confidential international comparison consultations were also undertaken with investors at external government-backed investment funds (especially funds of funds), to understand and validate the kinds of models that have been successful in similar markets.

2 Country Context

2.1 International Indices and Regional Comparators

Ethiopia is one of the fastest-growing economies in Africa. It compounded its GDP at an average of 9.6% annually in the period 2010–2017 and continues to perform well through the COVID-19 crisis. This strong ongoing growth is underpinned by a range of positive trends, including notable improvements in early-grade education as well as in food and health security. These factors, coupled with the progression toward liberalisation, have bolstered a growing perception, both in the region and worldwide, that the country is only starting to realise its economic potential.

Ethiopia has one of the continent's youngest median-age populations at 19.5 years. Nearly 40% of its 117 million people are under 14 years old, with the next 20% ranging from 15 to 24 years old.[6] While the youthfulness of the country's workforce is viewed positively in international investment markets but presents a fundamental near-term challenge as the country must find a way to absorb two million new entrants to the workforce each year.

There are some clear barriers to achieving the levels of economic growth that would enable employment growth on this scale. International indices often place Ethiopia in the lowest tercile of the measurable 190 countries. Ethiopia ranks:

- 151st for economic freedom in the 2021 Economic Freedom Index.[7]
- 159th for the ease of doing business according to World Bank, 2020.[8]
- 173rd for human development in the 2021 United Nations Human Development Index.[9]
- 126th for global competitiveness as ranked by the World Economic Forum, 2019.[10]

[6] "Ethiopia - The World Factbook," Central Intelligence Agency (Central Intelligence Agency, November 16, 2021), https://www.cia.gov/the-world-factbook/countries/ethiopia/#people-and-society.

[7] "Country Rankings," Country Rankings: World & Global Economy Rankings on Economic Freedom (The Wall Street Journal, 2021), https://www.heritage.org/index/ranking.

[8] "Doing Business 2020," documents1.worldbank.org (The World Bank, 2020), https://documents1.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf.

[9] Pedro Conceição, "Human Development Report 2020 - United Nations Development ...," Human Development Reports (United Nations Development Programme, 2020), http://hdr.undp.org/sites/default/files/hdr2020.pdf.

[10] "Global Competitiveness Index, 2019: Ethiopia," Reports (World Economic Forum, 2019), http://reports.weforum.org/pdf/gci4-2019/WEF_GCI4_2019_Profile_ETH.pdf.

Ethiopia's efforts to reduce corruption are delivering measurable results, however. The country has improved its ranking on Transparency International's Corruption Perception Index over the past decade from 120th in 2011 to 94th in 2020.[11] While this progress will bolster the country's efforts to attract new Foreign Direct Investment (FDI) across economic sectors, stakeholder interviews—both those conducted for this Note and those reported in the Government's Digital 2025 Strategy—indicate that private enterprise and entrepreneurs continue to view and experience corruption as a constraint on growth.

2.2 The Impact of COVID-19

At the time of writing, Ethiopia's economy had shown significant resilience in the face of the COVID-19 pandemic with IMF reporting that the country's GDP grew by 6.1% in 2020, even as the global economy contracted by 3.3% and GDP for Africa as a whole shrank 1.6%.[12] Despite challenges posed by cross-border restrictions and delivery logistics, Ethiopia's crucial agriculture sector grew by an estimated 4.3% in 2020 while slowing demand for luxury crops, such as flowers, was offset by proactive government policies and favourable climatic conditions. Unlike many other nations in Africa and across the globe, Ethiopia has chosen not to implement highly restrictive health measures. As a result, growth in the industrial sector remained strong, with construction expanding by 9.9% while continuing global demand for inexpensive textiles drove a 7.5% increase in manufacturing.[13]

[11] "Corruption Perceptions Index 2020: Ethiopia," Transparency.org (Transparency International, 2020), https://www.transparency.org/en/cpi/2020/index/eth.

[12] "IMF Real GDP Growth - Ethiopia," International Monetary Fund, accessed October 4, 2021, https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/ETH?zoom=ETH&highlight=ETH.

[13] "Economic Impact of the COVID-19 Pandemic on East African Economies, Volume 2," Deloitte (Deloitte, 2021), https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/finance/Economic%20Impact%20of%20the%20Covid-19%20Pandemic%20on%20East%20African%20Economies-Volume%202.pdf.

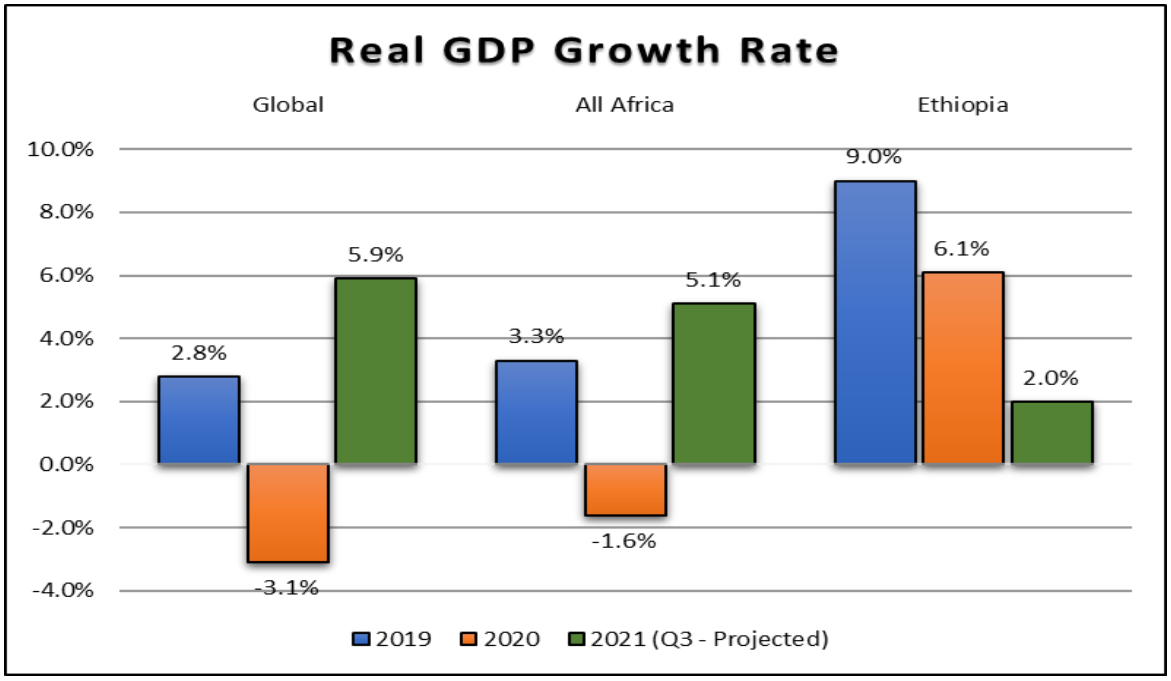


Figure 1 Ethiopia Real GDP Growth Rate, 2019–2021 (IMF)[14]

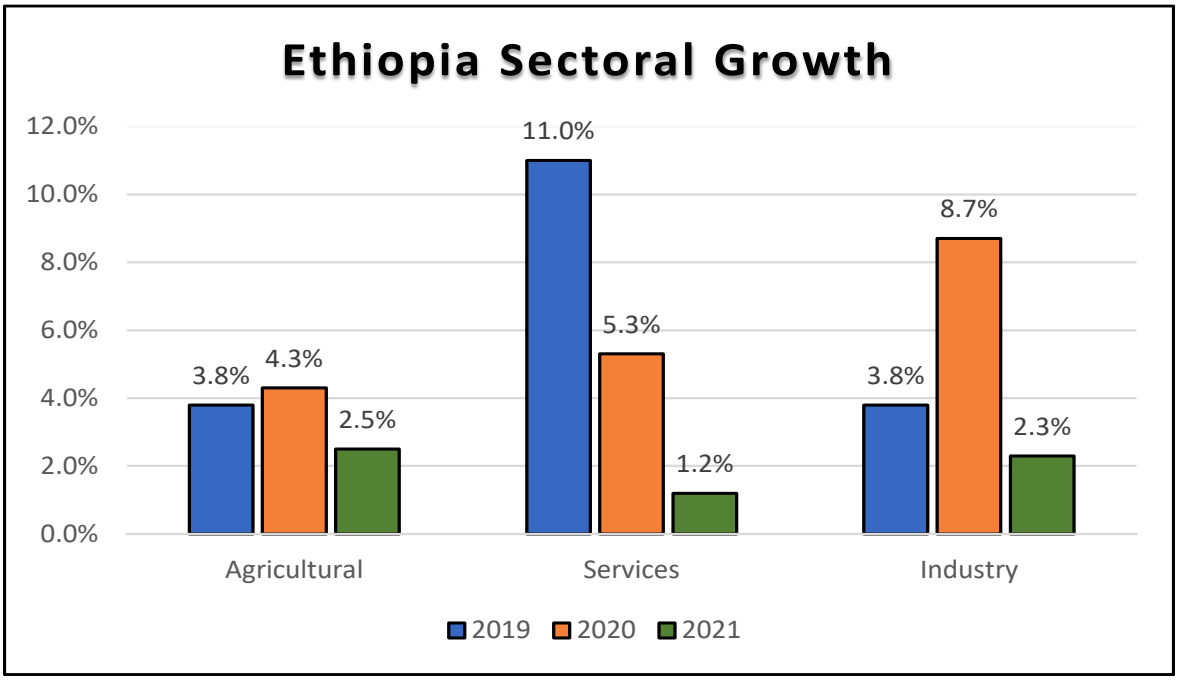


Figure 2 Ethiopia Sectoral Growth (Deloitte)[15]

[14] "IMF Real GDP Growth - Ethiopia," International Monetary Fund, accessed October 4, 2021, https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/ETH?zoom=ETH&highlight=ETH.

[15] "Economic Impact of the COVID-19 Pandemic on East African Economies, Volume 2," (Deloitte, 2021), https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/finance/Economic%20Impact%20of%20the%20Covid-19%20Pandemic%20on%20East%20African%20Economies-Volume%202.pdf.

Despite these strong results, Ethiopia has not escaped unscathed. The same recent data shows that the tourism industry, which contributed $893B USD to the global economy in 2019, slowed dramatically to $266B USD in 2020 and is expected to recover only modestly to $369B USD in 2021.[16] A World Bank blog published in November 2020 shows that 46% of households have experienced labour income losses. The same source states that 12% of urban workers, both informal and wage-paid, have completely ceased to work—twice the proportion of rural workers (6%).[17] Small and medium non-farm enterprises, the self-employed, and women and youth have all experienced greater-than-average losses in income.[18]

2.3 A Pivot Towards the Private Sector & Open Markets

A 2019 IFC Country Private Sector Diagnostic entitled "Sustaining Progress Towards Industrialisation" asserted that Ethiopia was at a "pivotal" moment in its economic development. After more than a decade of success, the public sector-led economic model was starting to suffer under the strain of rising youth unemployment and decreasing export values. The Government's ability to continue to use currency exchange and interest rate manipulation to support spending was waning and the risk of external debt distress was rated as "high" based on the 2017 Debt Sustainability Analysis indicators. In response, as noted in the IFC Diagnostic, the Ethiopian Government "…is revising its growth strategy to allow for a much greater role for the private sector in driving growth and job creation." [19]

The Homegrown Economic Reform Agenda of 2019 articulates the Government's commitment to move toward private sector development, digitalisation and an improved environment for both domestic and foreign investment. These policies aim to transition Ethiopia from an economy reliant on the production of primary and raw materials, especially in agriculture but also in mining, to one underpinned by the production of manufactured products and value-added services, both for export and for internal consumption. While import substitution is not neglected, the plan assumes that export-led economic growth will be spurred by improvements in the country's competitiveness, a rise in market opportunities, an increase in private sector growth and innovation, and growth in the percentage of product exports that are partially or fully finished hard goods or high-value creative and intellectual services.[20]

[16] "Economic Impact of the COVID-19 Pandemic on East African Economies, Volume 2," (Deloitte, 2021)

[17] Michael Weber, Amparo Palacios-Lopez, and Ivette Maria Contreras-González, "Labor Market Impacts of Covid-19 in Four African Countries," World Bank Blogs, November 18, 2020 https://blogs.worldbank.org/opendata/labor-market-impacts-covid-19-four-african-countries.

[18] ibid

[19] IFC, "Creating Markets in Ethiopia: Country Private Sector Diagnostic," ifc.org (IFC, https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/cpsd-ethiopia.

[20] "A Homegrown Economic Reform Agenda: A Pathway to Prosperity" (FDRE Ministry of Finance, September 2019), https://www.mofed.gov.et/media/filer_public/38/78/3878265a-1565-4be4-8ac9-dee9ea1f4f1a/a_homegrown_economic_reform_agenda-_a_pathway_to_prosperity_-_public_version_-_march_2020-.pdf.

2.4 A Focus on Digital Technology

Digital Ethiopia 2025 - A Digital Strategy for Ethiopia Inclusive Prosperity (Digital 2025), which was formally approved June 15, 2020, aims to advance the goals of the Homegrown Economic Reform Agenda by leveraging digital technologies to improve efficiency and add value to the dominant traditional economic sectors of agriculture, mining, and tourism. The Strategy also positions Ethiopia to take advantage of the outsized rewards the digitally interconnected global marketplace offers to nations that provide the comparative advantage of inexpensive labour in both light industry/manufacturing and high-value IT-enabled services (e.g., transcription, on-line research, social media marketing, digital content creation, and the full range of virtual customer assistance services). Digital 2025 echoes the 2019 IFC Diagnostic by asserting the importance of the private sector in securing the benefits of digital transformation across the economy. [21]

Many of the initiatives outlined in Digital 2025 are in progress. New directives and regulations from the National Bank of Ethiopia, including the National Digital Payments Strategy 2021-2024[22] and the Licensing and Authorization of Payment Instrument Issuers Directive no. ONPS/01/2020[23] are creating a more hospitable environment for digital payments and mobile money.

Importantly, the telecom industry is also being liberalised. In May 2021, an international consortium led by Safaricom purchased the first private telecom licence. A second round for licences that will include the right to provide mobile financial services such as mobile money, was announced on August 2, 2021.[24] It is anticipated that Safaricom's licence will be expanded to allow mobile financial services, and this is likely to bring Kenya's successful M-Pesa mobile money model into the Ethiopian market.[25]

---

[21] FDRE-MiNT, "A Digital Strategy for Ethiopia Inclusive Prosperity," mint.gov.et (MiNT, May 2020, p.2), https://mint.gov.et/wp-content/uploads/2021/05/Digital-Ethiopia-2025-Strategy-english.-.pdf

[22] National Bank of Ethiopia, "National Digital Payments Strategy, 2021-2024," nbe.gov.et (National Bank of Ethiopia, March 2021), https://www.nbe.gov.et/wp-content/uploads/pdf/directives/Payement%20system/National-%20Digital-%20Payment%20Strategy.pdf.

[23] "NBE Issues Directive to License, Authorize Payment Instrument Issuers," National Bank of Ethiopia, April 3, 2020 https://nbebank.com/nbe-issues-directive-to-license-authorize-payment-instrument-issuers-2/ and

"Oversight of the National Payment System," National Bank of Ethiopia, April 1, 2020 https://www.nbe.gov.et/wp-content/uploads/pdf/proclamation/oversight-the-national-payement-system.pdf.

[24] Endeshaw, Dawit, "Exclusive: Ethiopia to Reopen Bidding for Second Telecoms Licence, Officials Say," Reuters (Thomson Reuters, August 2, 2021) https://www.reuters.com/business/media-telecom/exclusive-ethiopia-reopen-bidding-second-telecoms-licence-officials-say-2021-08-02/.

[25] Brian Ngugi, "Ethiopia Clears Hurdle for M-Pesa Expansion," Business Daily Africa, August 6, 2021 https://www.businessdailyafrica.com/bd/corporate/companies/ethiopia-clears-hurdle-for-m-pesa-expansion-3500730.

Deeper Dive: Digital Financial Services

Digital Financial Services in Ethiopia

Currently, digital financial services are concentrated in the formal banking sector. The recent liberalisation of the telecommunications market, including licenses for operators to offer mobile financial services, is widely expected to increase penetration across geographies and social and economic levels

Bank customers at many institutions can use a combination of internet or mobile channels (USSD, internet or USSD-based smartphone apps) and, in the case of HelloCash, voice/interactive voice response to:

- transfer funds between accounts, including
  - their own accounts at the same institution,
  - other accounts which are set up for payments at the same institution,
  - payment accounts at a different chartered institution, and
  - mobile wallets.
- pay merchants via
  - push payments through QR code and
  - pull payments.
- withdraw and deposit cash via an authorised agent,
- pay employee salaries (Single Debit and Multiple Credit in real time), and
- collect payments from wholesalers and retailers.
- pay bills for:
  - most school fees,
  - DSTV Subscription,
  - Ethiopian Air tickets, and
  - some state-owned utilities.

Existing bank customers can register remotely for many services via mobile apps, Internet banking, USSD and, in the case of Dashen Bank's Amole service, Telegram bot.[26]

[26] Bank websites, https://www.awashbank.com/digital-channels; https://dashenbanksc.com/amole-payment-services/; https://hellocash.money/; https://www.bankofabyssinia.com/mobile-banking-in-ethiopia/.

2.5 Traditional Sectors: a 10-Year Shift & Technological Disruption

The Government's plan to promote technological efficiencies across the economy aims to leverage traditionally strong sectors from which existing capital may be reallocated for investment in technology. Through the Planning and Development Commission, the Government has forecast major shifts in its ten-year targets for the composition of the economy.

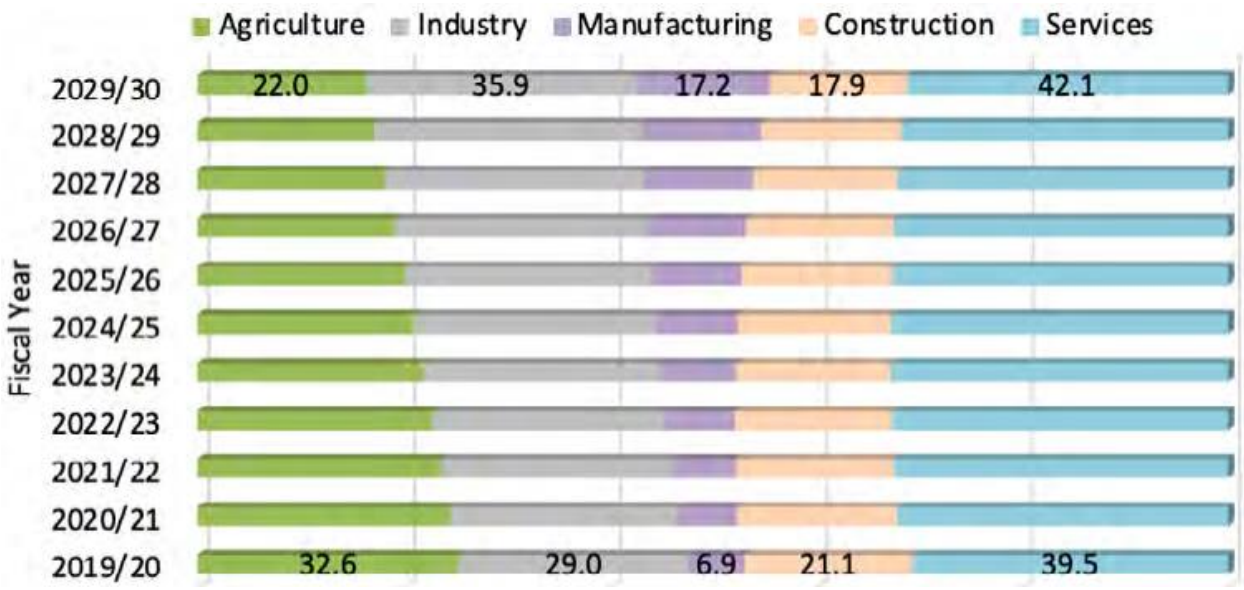


Figure 3 Ethiopia Ten-year Forecasts for GDP (%) (FDRE Planning and Development Commission)

As of 2020, the Ethiopian economy as measured by share of GDP was dominated by agriculture (32.6%), industry (29%), and services (39.5%).[27] According to Government projections, the manufacturing sector is expected to expand substantially over the next decade, from 6.9% currently to 17.2% of GDP by 2030. Consultant-conducted stakeholder interviews and research both suggest that most manufactured products in Ethiopia are currently produced with labour-intensive methods that involve little technology. To achieve the production efficiencies necessary to rebalance the country's trade deficit and enable competitively priced end-products would require wholesale adoption of the automation, advanced materials, and digital design tools widely used in other nations. This would in turn require extensive expansion and modernisation of both Ethiopia's manufacturing facilities and products: a transformation that would not be possible without a significant reallocation of capital. Research suggests that the Ethiopian manufacturing sector at present shows little appetite for investing in either product or process innovation.[28] Moreover, the stakeholders revealed that it is widely believed that additional infrastructure and policy development would be needed to enable the import of precursor materials, improve the clarity and process around zoning permissions, expand the electrical supply, increase logistics capacity, and reduce export-import bottlenecks.

The relatively modest expansion targeted in the broader Industrial sector (from 29% to 35.9% of GDP) might require similar capital reallocations, but with an emphasis on FDI which can support large-scale projects and operations. The regulatory adjustments in the financial sector to permit different investor classes, investment thresholds, and ownerships to support this are fully within the control of the Government and would be valuable across both traditional and emerging economic sectors.

[27] "A Homegrown Economic Reform Agenda: A Pathway to Prosperity" (FDRE Ministry of Finance, September 2019), https://www.mofed.gov.et/media/filer_public/38/78/3878265a-1565-4be4-8ac9-dee9ea1f4f1a/a_homegrown_economic_reform_agenda-_a_pathway_to_prosperity_-_public_version_-_march_2020-.pdf.

[28] Jeremy J. Wakeford et al., "Innovation for Green Industrialisation: An Empirical Assessment of Innovation in Ethiopia's Cement, Leather and Textile Sectors," Journal of Cleaner Production (Elsevier, August 9, 2017, pp. 503–511), https://doi.org/10.1016/j.jclepro.2017.08.067.

The greatest anticipated shift in Ethiopia's economic composition is a sharp reduction in agriculture's share of GDP, which is forecast to contract by nearly a third, to 22% from 32.6% by 2030, as industry, manufacturing, and services all make advances. As this change occurs, there are a growing number of technologies which can make agriculture more financially and environmentally sustainable. These include:

- drones for crop observation and targeted pesticide distribution,
- artificial intelligence and machine learning to guide feeding, storage monitoring, sprinklers, and selective breeding,
- automated seeding, feeding, and packaging, and
- sharing-economy methods for larger capital equipment.

The expected shift away from family farms and ranches is likely to increase the already substantial migration of a younger workforce into urban centres. This urban influx will bring with it a host of challenges relating to infrastructure, behaviours, housing, real estate, and—most importantly for technological adoption—entrepreneurship and training.

However, it is serial disruption in the services sector that promises to have the greatest impact on Ethiopia's standard of living and regional competitiveness. Among the emerging subsectors with the most potential to increase market access, economic participation, and financial inclusion are:

- last-mile delivery solutions,
- social media and on-demand creative content, and
- new financial products and payments methods.

The broad category of "services" includes a wide range of enterprise types, some of which are better suited to swift innovation than others. Something as simple as an app that allows clients and service providers to exchange documents will require regulatory clearance, security protocols, and substantial testing if it is to be employed in financial services. The same sort of app deployed to allow remote collaboration on the writing of a book or the casual sharing of tools would require minimum security, oversight, and reporting, and could be up and running within days of successful basic testing.

While the greater regulatory and security needs of certain subsectors will slow the rate of innovation, other factors such as user exposure to and appetite for technological advances will speed adoption, sometimes with the same category of enterprises. Most financial services professionals, for instance, use computers and engage in digitally enabled communications regularly. Many rural subsistence agriculturalists and craftspeople, in contrast, may have had very little exposure to these things. Interviews with entrepreneurs, conducted in the course of preparing this Note, indicated that the level of familiarity with digital technology in general had a direct impact on the rate of uptake of specific innovative offerings.

2.6 Addressing Cross-Sectorial Challenges:

2.6.1 Increasing Access to Electricity, Telecommunications, & Digital Connectivity

2.6.1.1 Access to Electricity

Ethiopia has made significant progress in delivering electrical power to its citizens. The World Bank and the International Energy Agency report that in 2019 slightly over 48% of people had access to electricity, a strong increase from 12.7% in 2000. USAID's Power Africa program notes that the "key issues continuing to face the sector include: the creditworthiness of the distribution and power generation utilities, conversion of foreign currency, cost-reflective tariffs, grid infrastructure, and off-grid populations." [29]

With the 2017 National Electrification Program, the Government announced its intention to reach universal access to electricity by 2025. This is ambitious but not impossible. Ethiopia has the capacity to generate much more power than it is expected to need for the foreseeable future and, because 97% of this comes from renewable sources, the country is cushioned against fluctuations in the hydrocarbon markets.[30] Approximately 80% of the population lives within the service reach of medium-voltage transmission lines. Planned improvements in last-mile delivery and Government policy changes to encourage privately owned off-grid renewable energy generation should quickly close the large gap in availability between urban populations (95% with access) and those in rural areas (32% with access).[31]

2.6.1.2 Access to Telecommunications and Digital Connectivity

Ethiopia ranked 108th out of 120 countries on the Economist Intelligence Unit's 2021 Inclusive Internet Index, with poor infrastructure, a weak competitive environment, and low literacy rates identified as key constraints.[32] The country fares equally poorly on GSMA's rankings of consumer readiness and available content.[33] This is not as bleak as it first appears. According to Ethio Telecom, about 42% of the adult population currently owns a mobile phone, with 21% having access to the Internet. While this is below the Sub-Saharan Africa average, it is very close to Kenyan levels prior to the advent of mobile payments solution M-Pesa.

[29] "Power Africa in Ethiopia: Power Africa," U.S. Agency for International Development (USAID), May 26, 2021, https://www.usaid.gov/powerafrica/ethiopia.

[30] "Ethiopia's Transformational Approach to Universal Electrification," World Bank (World Bank, March 8, 2018), https://www.worldbank.org/en/news/feature/2018/03/08/ethiopias-transformational-approach-to-universal-electrification.

[31] "Power Africa in Ethiopia: Power Africa," USAID, May 26, 2021

[32] "Overall Rankings," The Inclusive Internet Index (The Economist2021, 2021), https://theinclusiveinternet.eiu.com/explore/countries/performance.

[33] "2020 - GSMA Mobile Connectivity Index" (GSMA, 2020), https://www.mobileconnectivityindex.com.

After years of monopoly and prohibitive pricing, Ethio Telecom reduced prices by up to 50% in 2018, resulting in a sharp increase in data and voice traffic.[34] The deregulation of the telecommunication sector and the award of a telecom license to the Safaricom consortium are expected to create a rise in mobile uptake and penetration, spurred by competitive pricing and enhanced coverage availability. The combination of better pricing and availability will likely lead to a swift increase in the uptake of mobile services. This is likely to have many positive effects, ranging from the facilitation of distributed and remote working to increased financial inclusion through non-bank digital financial services, as it has in Kenya.[35]

2.6.2 Addressing Limited Participation in Formal Financial Services

Ethiopia's formal banking sector continues to expand, with slow but steady growth in the customer base for savings and transaction accounts and lending products. However, even though more than 60% of Ethiopians report putting savings aside, only 26% of all savers engage with a formal institution; the greater majority report saving with family members, friends, or through informal clubs (ROSCAs, or "susus"). This disconnection from the formal financial sector is also found amongst the 41% of Ethiopians who borrow, with just 11% of received funding coming from chartered institutions. The overwhelming majority is borrowed from family and friends or from savings clubs. This reliance on a widespread informal financial sector has meant that the existing credit bureau has limited information upon which to base credit ratings, which has hampered growth in credit and savings markets and insurance products, as well as capital market sophistication.

The adoption of the 2021 National Digital Payments Strategy and the granting of telecom and mobile money licences to privately owned mobile operators are likely to both drive down account and transaction charges and to make formal financial services more convenient.

[34] "Ethiopia - Telecoms, Mobile and Broadband - Statistics and Analyses," GlobeNewswire News Room (BuddeComm, November 16, 2020), https://www.globenewswire.com/en/news-release/2020/11/16/2127638/0/en/Ethiopia-Telecoms-Mobile-and-Broadband-Statistics-and-Analyses.html.

[35] Gabriel Demombynes and Aaron Thegeya, "Kenya's Mobile Revolution and the Promise of Mobile Savings," World Bank eLibrary (World Bank Group, March 2012), https://doi.org/10.1596/1813-9450-5988.

Leo Van Hove and Antoine Dubus, "M-Pesa and Financial Inclusion in Kenya: Of Paying Comes Saving?," *Sustainability* 11, no. 3 (2019): p. 568, https://doi.org/10.3390/su11030568.

& Olga Morawczynski, "Exploring the Usage and Impact of 'Transformational' Mobile Financial Services: The Case of M-Pesa in Kenya," *Journal of Eastern African Studies* 3, no. 3 (2009): pp. 509-525, https://doi.org/10.1080/17531050903273768.

2.6.3 Easing Restrictions on Foreign Participation in the Economy

2.6.3.1 Empowering the Diaspora

A new investment framework, consisting of the Investment Proclamation no. 1180/2020 (the "Proclamation") and the Investment Regulation no. 474/2020 (the "Regulation") came into effect in 2020. The new policies greatly improve the landscape for foreign investors, although significant restrictions remain. One change that should prove very helpful to the goals of job creation and skills transfer is the removal of the distinction between "Foreign Nations of Ethiopian Origin"—that is, Ethiopians who are no longer citizens due to single citizenship restrictions—and "Ethiopian Nationals". This update means that persons living abroad who were once Ethiopian citizens, or whose parents or grandparents were Ethiopian, are treated as "Domestic Investors" and may invest in almost every type of enterprise across every sector.[36] Similar adjustments to the definition of "Ethiopian National" have been made in the Banking Business Proclamation[37] and the Insurance Business Proclamation,[38] opening the way for the diaspora to fully participate in building the Ethiopian economy.

2.6.3.2 Consolidating Processes

The Proclamation and the Regulations together establish the Ethiopian Investment Commission (EIC) as an autonomous Federal Government Agency accountable to the Prime Minister. The EIC is charged with encouraging domestic and foreign investment by implementing and operationalising the Proclamation and Regulations. This includes the issuance of building permits, work permits, business licenses, commercial registration certificates, and investment permits, as well as registering trade/firm names and notarising memorandums and articles of incorporation. The consolidation of these functions should help to simplify Ethiopia's notoriously complex licensing process, although there are still complexities, as evidenced by the fact that investors establishing a new business receive their investment permit through the EIC, while investors wanting to buy an existing enterprise or shares must go through the Ministry of Trade and Industry.

The EIC's mandate is broad. It plays a key role in investment development, by negotiating and signing bilateral investment promotion and protection treaties with other countries, as well as by encouraging cooperation between non-equity based, export-oriented foreign enterprises and local investors. This makes the Commission an important partner in any effort to muster foreign investment for Ethiopian startups.

---

[36] "Ethiopia - Investment Proclamation No1180/2020," Investment Policy Hub (United Nations Conference on Trade and Development, April 2, 2020), https://investmentpolicy.unctad.org/investment-laws/laws/318/ethiopia-investment-proclamation-no1180-2020.

[37] "Banking Business Proclamation 1159-2019," National Bank of Ethiopia, 2019, https://nbebank.com/wp-content/uploads/pdf/directives/bankingbusiness/banking-business-proclamation-1159-2019.pdf.

[38] "Insurance Business Proclamation 1163-2019," National Bank of Ethiopia, January 9, 2020, https://nbebank.com/wp-content/uploads/pdf/directives/insurancebusiness/insurance-business-proclamation-1163-2019.pdf.

2.6.3.3 Opening New Investment Categories

The Regulations divide enterprises into three categories for investors: those available for foreign or domestic investment in concert with the Government; those that require foreign investors to invest jointly with domestic partners; and those reserved for domestic investors only. The framework uses a "negative list" approach—in other words, if an area of enterprise is not listed as restricted[39] it is deemed open for foreign investment. This allows greater flexibility for new and emerging businesses to tap foreign investment.

In an important departure from past policy, there are no areas reserved for government investment alone. Once-tightly controlled areas such as the manufacturing of weapons, international air transport services, the import and export of electrical energy, rapid transit, and non-courier postal services are now open to joint foreign or domestic investment with the Government.

The category of foreign and domestic joint investment is also new and allows foreign shareholders to hold up to a 49% stake. This category includes larger capacity (more than 45 passengers) urban and cross-country buses, shipping and forwarding for freight, accounting services (including auditing), and the broad areas of advertisement and promotion, audio-visual services, motion picture and video recording, production, and distribution services.[40]

[39] Prospecting, exploration and development of minerals and petroleum are the subject of specific mining and petroleum legislation

[40] "New Investment Proclamation No. 1180-2020 - Ethiopian, Chamber," Ethiopian Chamber of Commerce, April 2020, http://ethiopianchamber.com/Data/Sites/1/2012%20EC/Attachments/New%20Investment%20Proclamation%20No.%201180-2020.pdf.

Remaining Constraints

Thirty-two areas remain reserved for domestic investment. Many of these have been chosen to protect smaller, localised, labour-intensive businesses such as: barber shops, beauty salons, smithery and tailoring work (except by garment factories), tearooms, coffee shops, bars, nightclubs, restaurants, and smaller catering services. It is heartening to see some degree of foreign investment allowed in many areas of transportation, including domestic and international airlines, buses, railway transport, cable car transport, cold-chain transport, and heavy capacity freight transport.

The investment framework has also begun to open e-commerce to foreign investment. Although retail trade is restricted to domestic investors, this excludes "retail, as provided under appropriate law, of own manufactured products produced in Ethiopia and electronic commerce".[41] A similar exemption applies to wholesale trade. The definition of "electronic commerce" is left vague so it is not yet possible to determine to what extent foreign investment will be permitted to help power digital retail and wholesale platforms.[42]

Small scale foreign investment remains constrained by the following capital requirements:

- $200,000 USD for a single-project investment from a foreign investor,
- $150,000 USD if the investment is made in partnership with a domestic investor,
- $100,000 USD if the investment is in architectural or engineering works or related technical consultancy services, technical testing and analysis, or in publishing work, and is solely owned by a foreign investor.
    - $ 50,000 USD if the above investment is made in partnership with a domestic investor.

[41] "Investment Regulation No. 474/2020," Ethiopian Chamber of Commerce, September 2020, http://ethiopianchamber.com/Data/Sites/1/2013%20EC/Attachement/Investment_Regulation_No_474_2020.pdf.

[42] "The New Investment Legislations: Widening the Gateway to Foreign Investment in Ethiopia," Endris Amino Law Office, March 22, 2021, https://ethiopialawoffice.com/the-new-investment-legislations-widening-the-gateway-to-foreign-investment-in-ethiopia/.

3 The Digital Startup Economy in Ethiopia

3.1 Maturity Level of Ethiopia's Startup Ecosystem

In June 2021, Ethiopia rejoined the top 100 on StartupBlink's prestigious Global Startup Ecosystem Index—in 100th place. The rankings are designed to compare ecosystems and to show gaps between and among them in absolute terms. The composite score measures the quantity and quality of startups and supporting organisations, as well as the business environment for each ecosystem. The significant differences in scores between Ethiopia (.162) and African leaders such as South Africa (3.547), Kenya (1.565) and Nigeria (1.517), for instance, are large enough to suggest that merely transplanting funding and ecosystem support models that are current in these markets without adapting them to the Ethiopian context would be unwise. For this reason, the Note highlights learnings from Pakistan, Ghana, and Tunisia, as well as those from more advanced startup ecosystems.

Country	Global Startup Ecosystem Index Rank	Global Startup Ecosystem Index Score (comparative in absolute terms)
United States	1	124.420
Israel	3	27.741
India	20	8.833
South Africa	48	3.547
Kenya	61	1.565
Nigeria	63	1.517
Rwanda	69	.918
Egypt	70	.893
Pakistan	75	.490
Ghana	81	.399
Tunisia	82	.395
Somalia	94	.224
Uganda	97	.180
Ethiopia	100	.162

Table 2 Global Startup Ecosystem Rankings and Scores (StartupBlink)[43]

[43] "Global Startup Ecosystem Index 2021," StartupBlink, 2021, https://www.startupblink.com/startupecosystemreport.pdf?mc_cid=9dc40ae5f2&mc_eid=6f5381bffe.

3.2 Government Leadership

As already noted, the Federal Government of Ethiopia has made job creation, increasing the share of the economy that is driven by the private sector, and creating and growing micro-to-medium businesses key goals for the next decade. Strategies to achieve these are articulated in many recently adopted policy documents. The Homegrown Economic Reform Agenda and the Digital 2025 Strategy place special emphasis on the importance of nurturing of the small but promising existing ecosystem of digitally enabled startups—an approach that has culminated the currently proposed Startup Act.

Main Policies	Leading Government Organisations
Ethiopia: An African Beacon of Prosperity Ten-Year Development Plan 2020–2030	Planning and Development Commission
2019 Homegrown Economic Reform Agenda	Office of the Prime Minister
Industrial Development Strategic Plan and Roadmap 2013–2025	Ministry of Industry
Investment Proclamation no. 1180/2020 & Investment Regulation no. 474/2020	Ethiopian Investment Commission
National Entrepreneurship Strategy 2020–2025	Ministry of Trade and Industry
Digital Ethiopia 2025: A Digital Strategy for Ethiopia Inclusive Prosperity	Office of the Prime Minister
Business Startup Proclamation/Startup Act (in progress)	Job Creation Commission & Ministry of Innovation and Technology

Table 3 Recent Policy Initiatives, Ethiopia (Cenfri, 2021)

4 Qualitative Results: Self-reported Challenges for Digital Startups

Our detailed virtual discussions with members of the investment community, startup founders, ecosystem associations, incubators, and accelerators yielded a shortlist of perceived and self-experienced challenges that were almost universally expressed. In Annex 1, "Recommendations on the Policies of the Proposed Startup Act", this Note will outline the important policy steps the Government is preparing to take to address many of these concerns.

4.1 Cross-Sectorial Challenges to Starting & Running a Business

The World Bank's recent report on the Ease of Doing Business (EoDB) ranked Ethiopia 156th out of 190 countries assessed. This ranking validates the feeling expressed by entrepreneurs interviewed for this Note: that running a business in Ethiopia is an arduous undertaking. According to the same EoDB report, starting a business is an even greater challenge. Ethiopia ranked 168th in this category, while nearby Rwanda and Egypt came in at 35th & 90th, respectively.

While the factors that led to Ethiopia's relatively low placement on the EoDB scale affect companies of all sizes, they hit startups and micro, small & medium enterprises (MSMEs) hardest. In recognition of this, various Government agencies and regulators have taken steps to ease regulatory frictions and hurdles, including:

- establishing a Doing Business Reform Steering Committee,
- revising key business rules & regulations,
- amending the Value Added Tax (VAT) proclamation, and
- introducing an Ethiopian Electronic Single Window: a web-based platform for processing international trade regulatory documents.

4.1.1 Lack of Fast-track Company Registration

The EoDB report estimated it takes 32 days to set up a business in Ethiopia, versus an average of 21.5 in Sub-Saharan Africa as a whole and 0.5 in global top performer New Zealand.[44] Respondent stakeholders emphasised that the difficult company registration process disheartens aspiring local entrepreneurs with startup ideas and discourages diaspora investors who might wish to launch new businesses or support young companies.

The Startup Act includes policies intended to address this barrier, among others. These are outlined in Annex 1, 9.2.9.

[44] World Bank's Ease of Doing Business Report (last reported 2019), https://data.worldbank.org/indicator/IC.BUS.EASE.XQ?end=2019&locations=ET&start=2019&view=chart.

4.1.2 Lack of Differentiated Taxation for New Businesses

A large majority of startup enterprises across the globe begin life as loss-making entities and remain so for the first few years after incorporation. As they push to gain customer recognition, compete with established entities, and build a viable product, startups often dedicate most of their liquid cash to making the business work. The earliest revenue streams generated by fledgling companies are seldom enough to do more than offset expenses, which means it is often necessary for founders to pour every penny of available capital into growth if they hope to survive.

Given these financial realities, the taxation law in Ethiopia does not adequately differentiate startups from established businesses. It requires all companies to pay a minimum tax on overall revenue, irrespective of whether a business is earning a profit or operating at a loss. Both public and private sector stakeholders expressed concerns that the burden of taxation during the early years of operation drains a startup's scarce resources at a stage when it is most vulnerable.

The Startup Act includes policies intended to address this roadblock, among others. These are outlined in Annex 1.

4.1.3 Lack of Business Knowledge

The private sector stakeholders who represented incubators in the qualitative interviews conducted for this Note reported that many of the aspiring entrepreneurs looking to create startups have extremely limited professional experience and little understanding of what it takes to run a business. Most have never been taught the basics of business management—essentials such as: how to develop a viable business model; how to create a financial forecast; what to include in a pitch to investors, and how to find and develop talented staff. Without a grounding in these vital business building blocks, many have difficulty juggling management tasks, and can face presentation and communication hurdles when trying to raise capital. Stakeholders from established digitally enabled businesses echoed this concern when they discussed the difficulties they face hiring "job-ready" staff.

This dearth of management acumen is evident in Ethiopia's low ranking (123rd of 132) on the Global Talent Competitive Index, an annual benchmarking tool that ranks countries based on their ability to develop, attract, and retain talent.

The Government has moved to address this via measures in the Startup Act which supports public sector employees when they join the startup workforce (Section 9.2.2) and proposes a scholarship program (Section 0) as well as through ongoing efforts to improve access to quality education across the nation.

4.1.4 Lack of Access to Business Workspaces

Private sector stakeholders report that renting workspace is an expensive proposition for early-stage entrepreneurs, who must navigate an environment where commercial and private landlord and tenancy legislation is weighted in favour of the landlord. For instance, it is reportedly common practice for landlords to require significant advance rent along with large security deposits.

Entrepreneurs who lack the capital to meet this hefty up-front requirement are often compelled to operate from their homes or from spaces provided by friends and family, which in turn can create privacy issues and challenges around resource-sharing and collaborative work as the core team expands. While the lack of a formal workspace may initially be less debilitating for digitally enabled startups focused on developing intellectual property than for new businesses that deal in physical goods, even in this subsector—as this Note sets out below—the absence of physical collateral creates its own difficulties by being a barrier to credit.

This challenge is addressed in the discussion on empowering incubators and accelerators, Section 6.3.6.

4.2 Challenges Mainly Specific to Digital Startups

4.2.1 Lack of Appropriate and Focused Mentorship

Mentors can play a critical role in helping founders learn the skills they need to solve product development and management problems. The stakeholders we interviewed indicated that the founders of most early-stage startups have high hopes of receiving meaningful guidance and access to knowledge-sharing though participation in an incubator program. However, a combination of factors, including high fees, lack of available openings (especially outside of Addis Ababa), and dissatisfaction with the services and culture of the incubators mean many instead turn to informal networks to find experienced support. Often these informal mentors have business or economics training but experience in an unrelated industry or the public sector and would be better suited to give guidance later in the startup process. This reliance on friends, family, and people of one or two degrees of separation exacerbates the divide in outcomes between relatively wealthy and socially well-connected entrepreneurs and those with little wealth and modest social origins.

As already noted, Ethiopia is currently ranked well below its regional competitors on the Global Startup Ecosystem Index. This is due, in part, to a scarcity of accessible support programs and a lack of diversity in incubating methods. There is simply not enough capacity and breadth of knowledge within the existing incubator/accelerator network to adequately nurture many of the potentially successful early-stage disruptive ideas. An August 2021 AfroLeap article reports that there are approximately 20 startup incubators and accelerators in Ethiopia, most of whom are in partnership with development donors

such as GIZ, MasterCard Foundation, and United Nations organisations,[45] and therefore influenced by their mandates.

The private sector stakeholders interviewed indicated that independent incubators and accelerators also require significant equity—in some instances as much as 10%—as a fee for joining a program, which puts them out of the financial reach for many early-stage companies. Independent incubators and accelerators often lack a regular income stream and startup equity takes time to generate capital. As a result, they offer, in the opinion of some of the stakeholders, generic services with mentorship engagements often confined to one-off events. Donor-funded organisations, such as the UNDP Accelerator Lab, have better resources but may be limited in their ability to tailor their large, multi-country programs to the Ethiopian market. blueMoon, which has become the best-known Ethiopian incubator/accelerator, has a deliberately restrictive and hyper-competitive intake process, and accepts less than 1% of the candidates who apply to its programs.[46]

A cursory assessment of the prevalence of incubators and accelerators via journalistic reporting and a review of websites suggests there are more options than the stakeholders suggest. However, when these sources were investigated, many of the websites advertise entities that have never actually provided any services. When the consultants contacted a journalist at AfroLeap to investigate their reported claim that "The country has close to 15 startup incubators and 64 accelerators such as iceaddis, blueMoon, and X-hub Addis", the reporter replied: "I used the figures using a local news report as a source. But now I really doubt those figures are accurate…I think there are close to 20 startup incubators and accelerators in Ethiopia, … including the ones under formation."[47] This uncertainly highlights the need for the Government to regulate entities' that wish to gain access to the privileges which are being made available to supporters of the startup ecosystem and gain access to the support which is being offered. The vast majority of the functioning startup ecosystem support organisations are centered in Addis Ababa, creating a large divide in the availability of opportunities between urban and rural entrepreneurs.[48]

[45] Kaleab Girma, "Despite Lack of Outstanding Hatches, Startup Incubators Continue to Launch in Ethiopia," AfroLeap, August 7, 2021, https://afroleap.com/despite-lack-of-outstanding-hatches-startup-incubators-continue-to-launch-in-ethiopia/.

[46] "Application and Selection Process," blueMoon, accessed December 23, 2021, https://www.bluemoonethiopia.com/bluemoon-incubator/application-and-selection-process/.

[47] Private email exchange, included as an addendum to the Bibliography 9.1.1

[48] "Ethiopia Startup Ecosystem - Middle East & Africa," StartupBlink Blog, May 26, 2021, https://www.startupblink.com/blog/ethiopia-startup-ecosystem/.

4.2.2 Lack of Official Voice

Many stakeholders expressed that they did not feel that the Government of Ethiopia had a strong understanding of their needs and challenges. This perception exists despite the activities of both the Jobs Creation Commission (JCC) and the Ministry of Innovation and Technology (MInT) including Startup Act which seeks to address most of the concerns which the stakeholders articulated. It seems that both JCC and MInT have failed to communicate their roles and actions in a manner that resonates with the startup community. Numerous interviewees expressed the desire for an inclusive, non-governmental advocate organisation prepared to lobby for policy intervention and regulatory changes. We address this in Section 6.3.3.

Many other countries that have embarked on a pro-entrepreneurship path have identified the lack of knowledgeable advocacy as an issue and have created various structures— e.g., government committees and/or private sector organisations—charged with promoting the aims of startups. Startup India was founded for the sole purpose of addressing and resolving the concerns of newly formed companies and promoting the startup sector. This highly successful agency also maintains a one-stop digital portal that gives startups a 360˚ view of all the policies, schemes, and incentives available to them.

4.2.3 Lack of Appropriate Policies and Oversight

Technology-enabled startups and other industry disruptors frequently create markets for which no existing policy is readily applicable. Policymakers often respond to such innovations by shoehorning them into existing frameworks that have insufficient definition or scope to account for them. Enforcing ill-fitting regulations against market-creators causes visible risk-aversion amongst technology investors and deters both entrepreneurs and innovators. Many of the stakeholders reported that technology startups often find themselves in grey zones between regulators which are murky and difficult to navigate. A recent report from Cepheus Growth Capital Partners provides an example: “setting up a company without a physical office is no longer required by regulations but still not consistently accepted by the revenue authority”.[49] One surveyed respondent noted that multiple agencies tried to regulate that entrepreneur’s business, and the company felt beset with hindrances that had little to do with the core business.

Lack of coordinated policy and regulation allows room for misunderstanding by supervisory personnel and, occasionally, for misbehaviour by individuals who may try to exploit the entrepreneur by threatening enforcement. For businesses operating without clear rules, the threat of being penalised or shut down by a misbehaving or misinformed regulator is a potentially calamitous risk.

The Government has taken a major step towards recognising the unique needs of startups through the Startup Act, a discussed in Annex 1.

[49] Ethiopia’s Digital Economy,” Cepheus Growth Capital Partners, accessed October 3, 2021, https://cepheuscapital.com/wp-content/uploads/2019/01/Ethiopias-Digital-Economy.pdf.

5 The Primary Challenge: Lack of Access to Finance Across all Stages of Growth

"Ethiopian entrepreneurs have few options for funding. Local specialised investors are rare, foreign players are wary of entering a closed economy, and banks are not geared towards the needs of startups. There is limited investment to capitalise on potential projects."—**Ethiopia Startup Ecosystem Review, 2021 Global Startup Ecosystem Index compiled by StartupBlink**.[50]

The Government of Ethiopia is keenly aware that the number one challenge facing startups is access to financing. This is common across most developing economies as formal lenders are seldom able to assess the risk and return potential of business based on intellectual rather than "hard" assets. The Homegrown Reform Agenda lists "limited access to finance for entrepreneurs and startups" as one of the six roadblocks to information and communication technology (ICT) penetration and one of the four main macroeconomic imbalances threatening the economy.[51] The Digital 2025 Strategy report, meanwhile, found that access to finance was the most reported constraint to development. The lack of access to finance at all stages of the startup journey was also cited as a key impediment by every one of the stakeholders interviewed for this Note.

From conception through to early VC stages, startups in Ethiopia face major challenges in raising formal funding. Many promising ideas die on the vine as soon as their capital requirements exceed what founders, extended family, and friends can risk. This funding squeeze delivers a two-fold blow to Ethiopia's economic prospects. Not only is the wider economy being deprived of the potential benefits of any number of promising new ventures, but a next generation of innovators is being discouraged from pursuing their ideas by a shortage of successful role models. One of the startup founders interviewed during the consultation phase said they nearly gave up trying to bring their concept to life because they had heard so many stories of people losing both personal and family savings when their young businesses failed because they were unable to find financial backing at the critical growth juncture often referred to as the "Valley of Death" (see figure 4, below).

[50] "Global Startup Ecosystem Index 2021," p. 252, StartupBlink, 2021, https://www.startupblink.com/startupecosystemreport.pdf?mc_cid=9dc40ae5f2&mc_eid=6f5381bffe.

[51] "A Homegrown Reform Agenda: Unlocking Ethiopia's Economic Potential," FDRE Ministry of Finance, August 2019, https://www.mofed.gov.et/media/filer_public/0e/4c/0e4c0c11-8262-4e53-b395-0b1c0aa26976/ethiopia-_economic_reform_agenda_.pdf.

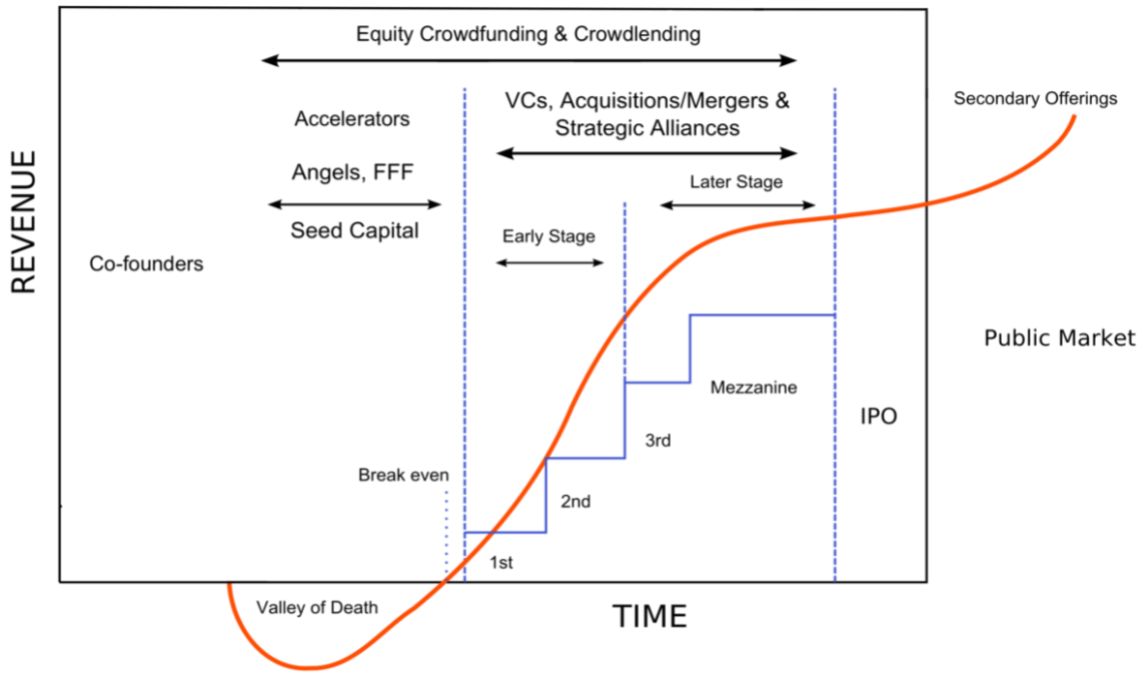


Figure 4 Startup Funding Cycle (Public domain)

Stakeholders articulated several specific problems that fit under the broad heading of "funding problems for startups". These can be grouped into the following subcategories: Inequality of Founder, Family and Friends Capital, Reluctance to Invest in Innovation, Lack of Formal Lending, Scarcity of Seed Capital and Angel Investors, and an Undeveloped VC Market.

5.1 Inequality of Founder, Family & Friends Capital

A lack of investor support and limited access to early-stage capital from banks or other sources compels most entrepreneurs in Ethiopia to self-fund their new enterprises to the best of their abilities, including turning to their (often) financially limited networks of extended family, professional contacts and friends to supply their seed capital.

This inevitably results in inequality of opportunities, as founders from well-connected families or with more established professional contacts will have much greater access to early-stage support than those with more modest networks, regardless of how promising an idea may be. There is a similar divide when it comes to educational attainment, as a university-educated individual will have a greater chance of knowing others who, by virtue of their academic achievement, have secured well-paying employment and are therefore more able to invest. It is easy to see how these two factors would stack the deck against a low-income rural innovator who has not had the opportunity to go to university. Yet it is precisely an individual from this background who is likely to come up with the foundational concepts for ground-breaking agritech.

The recent Government decision to reclassify members of the diaspora as domestic rather than foreign investors will make them exempt from the $200,000 USD minimum investment requirement. This is expected by many of the stakeholders consulted to result in a substantial increase in funding, albeit in small amounts, for young businesses. It is widely understood that many people of Ethiopian origin who live abroad have been able to improve their economic condition and will be eager to leverage the purchasing parity power of the currencies they earn abroad to help their entrepreneurial friends and family.

5.2 Reluctance to Invest in Innovation

Both public and private sector respondents interviewed expressed the opinion that most Ethiopian investors, including banks, feel unable to assess the risk and reward potential of startups due to a lack of knowledge or experience with innovation and new technology. They felt, in general, that this has resulted in much of Ethiopia's domestic investment, whether credit or equity-based, becoming concentrated in the traditional sectors of real estate, agriculture, and light manufacturing. This perception is confirmed by the Ethiopian National Innovation Survey of 2019 which cited indicated that formal domestic lenders, such as banks and savings and credit cooperatives, lack the specialised skills, found in international financial institutions, required to evaluate intellectual capital based on new and disruptive technology and are therefore reluctant to branch out from traditional industries.[52]

5.3 Lack of Formal Lending

From across the spectrum, the respondent stakeholders reported a critical lack of formal credit lending available for new businesses. Financial institutions in Ethiopia are said to be extremely conservative lenders. Not only are they reluctant to make commercial loans, but they require high levels of collateral when they do. This means that all lending must be secured by physical collateral appraised at 2x to 3x of the loan value.

Technology-enabled startups, by virtue of their digital nature, rarely have the necessary physical assets to qualify for such lending, particularly during the very early stages of their development. To compound the challenge, the credit bureaus, hampered by the lack of participation in formal financial services, can offer only limited support to financial institutions looking to evaluate leading requests. These constraints deprive most digital startups of the deep pools of bank financing available to enterprises operating in traditional industries—capital availability that only reinforces the widespread and unhelpful perception that investing in old-school sectors is wiser than supporting innovative newcomers.

[52] Belachew Asfaw, "Ethiopian National Innovation Survey-2019," ResearchGate (FDRE Technology and Innovation Institute, 2021), https://www.researchgate.net/publication/349809596_Ethiopian_National_Innovation_survey-2019.

While raising funds is challenging for all startups, interviews with stakeholders indicated that the problem is far more acute for female entrepreneurs. Banks, already hesitant about lending to startups, are even more reluctant to lend to female-led businesses. Credit officers often have an incorrect and preconceived expectation that women will have a divided level of commitment to the venture.[53] The stakeholder consultations yielded numerous accounts of unpleasant bank experiences for female entrepreneurs.

5.4 Lack of Early-Stage Funding

The challenge of accessing capital does not necessarily end when a digital startup begins to gain traction.

According to consultations with a number of successful startups and a regional fintech association, alternative and innovative early-stage funding models such as revenue or royalty-based financing—in which investors agree to provide capital to a company in exchange for a pre-agreed percentage of the company's gross revenues—and SAFE (simple agreement for future equity) financing—in which investors provide capital in return for company stock at a later date, in connection with a specific event—are almost unknown. This means that early-stage startups are almost entirely reliant on debt products and seed and angel investors for funding.

Unfortunately, the vast majority of potential early-stage investors are based offshore, and as such are hampered by Ethiopia's minimum foreign investment cap of $200,000 USD, which sets a high requirement for what are deemed by most to be very risky investments. As a result, domestic angel and seed funders, such as the newly formed Addis Ababa Angels Network, and regional players with local offices, such as RENEW's Impact Angel Network and the Baobab Network, must carry most of the load. It is telling that only one of the sixty-four African startups currently supported by international seed funding powerhouse Y Combinator—the drone delivery enterprise Avion—is Ethiopian and that the world's largest pre-seed startup accelerator, the Founder Institute, only entered the Ethiopian market in July 2020.[54] With such severe limitations on funding from domestic and international angels and seed funders, donor organisations and the networks they support end up playing key financing roles.[55]

[53] "Case Study: Universal Credit Scoring for Female-Led SMEs in Ethiopia," LenddoEFL, May 18, 2021, https://lenddoefl.com/news/2021/5/17/case-study-universal-credit-scoring-for-female-led-smes-in-ethiopia.

[54] "First Ever Founder Institute Ethiopia Startup Accelerator Opens Applications. Let's Build the Future.," The Founder Institute, June 2020, https://fi.co/insight/first-ever-founder-institute-ethiopia-startup-accelerator-opens-applications-let-s-build-the-future.

[55] "Ethiopia's Digital Economy," Cepheus Growth Capital Partners, accessed October 3, 2021, https://cepheuscapital.com/wp-content/uploads/2019/01/Ethiopias-Digital-Economy.pdf.

5.5 Low Volume and Value of VC Investment

A 2020 investment report by GIZ, Global Business Network, and Make-IT Africa identified only 22 VC groups active in Ethiopia, of which only five were domestic.[56] As the chart below indicates, Ethiopia receives a disproportionately small amount of the VC capital which flows to Africa.[57]

2020 Africa Tech VC – Equity funding per country (in US$M)

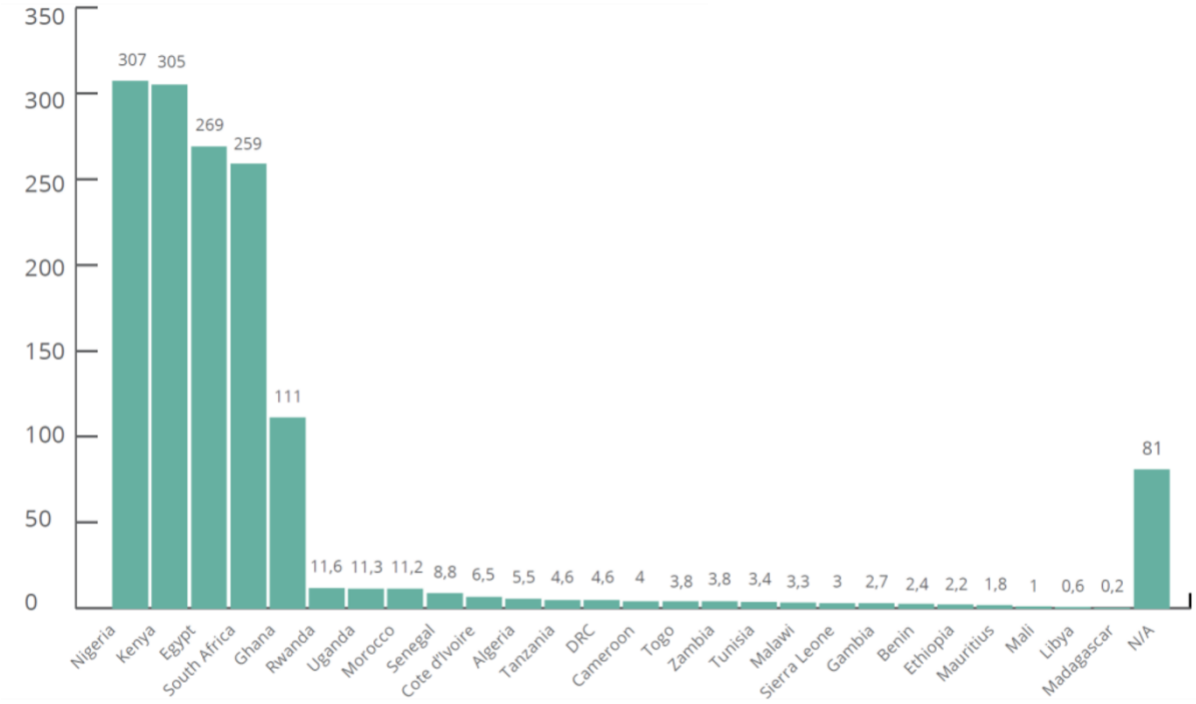


Figure 5 2020 Africa Tech VC - Equity funding per country (Partech Analysis)

Furthermore, local VCs have frustratingly unrealistic performance expectations, according to startup founders interviewed. One interviewee cited the example of an investor who demanded that a company produce revenue prior to investment. Comments from investment-side stakeholders seemed to bear out this perception. They said that while a pre-revenue company is indeed a possible investment opportunity, they would need evidence that a proposed business model has been proven elsewhere (e.g., ride-sharing or heavy equipment sharing). Such mismatches between the expectations of investors and entrepreneurs are often indicative of inappropriate policy measures and may leave the truly innovative or Ethiopia-specific startups out in the cold.

[56] "Scale Up! Entrepreneurs' Guide to Investment in Ethiopia," Investment Guide Africa (GBN/GIZ, September 3, 2019), https://investmentguide.africa/sites/default/files/2020-08/GETFIN_Ethiopia.pdf.

[57] "The State of Tech in AFRICA, 2021," AfricaArena Wired, March 25, 2021, https://f1d0651a-c40a-4877-b5d5-7f6204467ba9.filesusr.com/ugd/cdd60c_5d9debf5822c4e84940b69925d8d2ba2.pdf.

It is important to note here that simply increasing the amount of venture capital in the market will not eliminate the challenges of pre-revenue investing when an opportunity requires especially high numbers of very specialised, experienced technicians over long development cycles (e.g., drug discovery, fusion, rocket design) because there is not yet sufficient capacity for such enterprises available within the Ethiopian workforce.

5.6 Constraints in Raising International Investment

5.6.1 Minimum Investment Requirement

Despite the afore mentioned reforms undertaken by the Government, the regulatory environment in Ethiopia still discourages international investors from investing in the country. One such key restriction, already mentioned, is the required minimum direct investment of $200,000 USD. Several stakeholder respondents cited this as the key limiting factor for early-stage to seed-stage startups when they attempt to raise international capital. Most smaller investors would regard this sum as more than they would be willing to risk on an unproven business operating in a developing economy.

5.6.2 Real and Intellectual Property Ownership

Currently all land in Ethiopia technically belongs to the Government. Domestic individuals and businesses hold property on a 99-year lease and rural agriculturists have the right to an indefinite lease. However, the law clearly allows the FDRE to expropriate land as needed for the "common good". This creates a sense of unease for foreign investors in businesses with significant physical capital such as manufacturing. It is much less worrisome for those who invest in enterprises which hold their value in ideas and digital processes, such as most technology startups.

Nevertheless, there are challenges in the area of intellectual property rights (IPR) which are very detrimental to the value of digital startups. Although the Government has signaled its intent to sign and ratify the major IPR treaties, Ethiopia is currently not a signatory to the Berne Convention for Literary and Artistic Works, the Madrid System for the International Registration of Marks, the Paris Convention for the Protection of Industrial Property, the Patent Cooperation Treaty or the World Intellectual Property Organization (WIPO) Copyright Treaty. Ethiopia is also not a party to the Trade Related Aspects of Intellectual Property Rights (TRIPS) Agreement, nor has it completed its process for membership in the World Trade Organization. The agency responsible for protecting software rights, copyrights, and patents, the Ethiopian Intellectual Property Office, does not have law enforcement authority and is notoriously underfunded. This uncertain environment for IPR will hamper Ethiopia's to attract high quality foreign investment.[58]

[58] "Ethiopia - Country Commercial Guide - Market Challenges," International Trade Administration (US Government, 2021), https://www.trade.gov/country-commercial-guides/ethiopia-market-challenges.

5.6.3 Forex & Repatriation

International investors into Ethiopia face considerable foreign exchange (Forex), interest rate and inflation risks. Forex is continually in short supply due to poor export performance and the high demands for foreign currency. The Central Bank of Ethiopia claims thirty percent of the Forex which comes into commercial banks, from which it pays for major government infrastructure projects, external debt repayment and priority imports—such as health care equipment, pharmaceuticals, educational material, heavy equipment and parts to service machinery. Forex requests from business and investors end up waiting near the back of the queue. It is not unusual for a business Forex request to take months to be resolved. This spread of time between the request for and the release of foreign dominated funds carries the risks of changes in exchange value and exposure to inflation, which is currently exceeding 20%.

The lack of timely access to Forex plays havoc with the good intentions of Ethiopia's recent Investment Proclamation. The Proclamation creates the regulatory framework to allow foreign investors to remit the salaries of foreign employees, the principal and interest on foreign loans, the dividends and profits from investments, and the proceeds from the sale of assets. The reality remains, as noted above — weeks or months of waiting and exposure to risk.

The Forex situation will be a major deterrence to foreign investors of all types and is something that must be addressed in the structuring of the "Jumpstart Ethiopia" VC Fund of Funds, starting with creating the appropriate ability to "currency swap" which will likely require the Fund to be domiciled offshore. It will also make it difficult to hire top talent to work in Ethiopia and therefore potentially limit the effectiveness of the domestic investment vehicle, including many of the ecosystem funds, and decrease the availability of expert mentors to help build the Ethiopian startup investor community. In the short term, these challenges may be able to be overcome by very favourable contractual terms for in-country foreign experts but in the long term this is a systemic problem that the Government will have to address with a steady program of reform.[59]

[59] Eline Bakker, "Strengthen WASH Business in Ethiopia: Access to Foreign Exchange," IRC, 2020, https://www.ircwash.org/news/strengthen-wash-business-ethiopia-access-foreign-exchange.

6 Recommendation: The Creation of a Comprehensive Framework to Empower a Digital Startup Ecosystem — "Jumpstart Ethiopia"

6.1 Foundational Concepts

6.1.1 Implement the Startup Act According to Global Best Practices

The Startup Act (the "Act") establishes clear parameters for which enterprises are to be labeled "startups", "innovative businesses" or "ecosystem builders" and outlines the incentives that will be available to each. The Act champions the establishment of a National Startup Council, consisting of public sector stakeholders appointed by the Prime Minister and led by the Minister of Innovation and Technology (MInT), which will be responsible for ensuring the creation and maintenance of an ecosystem of support for startups. The Act also proposes to address the crucial lack of access to investment capital through the creation of a National Innovation Fund, with a wide mandate for both sourcing funds (government revenues, designated loans, donations/endowments) and distributing them via grants, credit guarantees, subsidised loans, and capital investments.

As the Act has yet to be put into practice, the writers of this Note feel it to be within their mandate to suggest approaches to its implementation that are aligned with global best practices and appropriate to the Ethiopian context. This Note proposes the creation of a semi-autonomous operating entity (SAOE) that would provide a wide range of services and supports for startups, under the oversight of a board comprised of both public and private sector stakeholders. This independent board could report to the proposed National Startup Council or to the Ministry of Innovation and Technology.

Many of the modifications, which are detailed in Annex 1, could be put in place via a set of regulations that spell out the implementation details of the Act. The goal of creating a system with autonomy from the Government would be best enshrined in the initial legislation through changes to the Act as it goes through the parliamentary approval process but could also be addressed through policy and regulation to guide its implementation.

Most importantly, this Note strongly recommends that the concept of a National Innovation Fund be implemented as a large venture capital fund and a series of smaller, special purpose funds under the direction of the Investment Unit of SAOE. As such, the SAOE would also be responsible for staffing and overseeing an investment unit comprising a VC fund of funds and a selection of secondary special purpose funds. The separation of the VC investments from the more goal-specific funds allows for appropriate investment strategies, life cycles and fund rules for each purpose.

6.1.2 Autonomy and Shared Public-Private Governance

It is highly recommended that the Government follow the model of the recent World Bank-supported Smart Capital initiative in Tunisia and create a separate entity to implement the funding and ecosystem development policies of the Startup Act. This entity should be governed by a board of directors that includes representatives of the appropriate government ministries, regulatory authorities, and the private sector. This board could report to the proposed National Startup Council or to the Ministry of Innovation and Technology and should also be under the financial supervision of the Federal Auditor General. No government agency should directly control the process of hiring fund managers or be seen in any way to hold sway over investment strategies.

6.1.2.1 Alignment between Government of Ethiopia and SAOE

Figure 6 Alignment between Government of Ethiopia and SAOE (Digital Financial)

The establishment of a distinct entity has enabled countries such as India and Pakistan to work closely with the private sector to nurture entrepreneurship while mitigating concerns about undue influence that could limit the support of private investors, development institution partners, and the public. The fact that the SAOE is not solely staffed by public sector employees will allow it to weather changes in government and to maintain its reputation in the face of any political scandals. This arms-length approach also protects the Government from charges of mismanagement should SAOE-facilitated investments or SAOE-supported startups perform poorly. The commitment to include the private sector when shaping policy at the highest levels will help to keep the Government up-to-date with the fast-changing needs of the startup ecosystem.

6.1.3 Enable "Quick Wins" While Building for the Future

This report acknowledges that it will take significant effort and at least 12 months to establish, implement, and operate the priority investment vehicles which are recommended in Section 6.2.1. To support Startups immediately, the Government of Ethiopia should, financially and through policy, support the "Jumpstart Ethiopia" SAOE to swiftly enable "Quick Wins" such as a Tech Credit Fund (Section 6.2.2.1), a Tax Refund Fund (Section 6.2.2.2), an Innovation Challenge Fund (Section 6.2.2.3), a Credit Loss Guarantee Fund (Section 6.2.2.4), a Startup Facilitation Program (Section 6.3.1) and a program to Empower Incubators and Accelerators (Section 6.3.6).

6.1.4 Ecosystem Approach

Individual startups do not exist in a vacuum. Startup success requires the Government to nourish and promote the whole ecosystem. It is also why these Recommendations include the creation of an Ecosystem Unit under the stewardship of "Jumpstart Ethiopia". This is discussed in more detail below.

In the short- to medium-term, the Government can foster startups and innovative businesses across the ecosystem by:

- continuing to improve policies, regulation, and infrastructure,
- providing startups access to the right funding at the right stages of development, from early-stage grants to later-stage VC investment,
- supporting a wide range of organisations that will offer vital help to the ecosystem—incubators and accelerators, colleges, technology and business schools, as well as mentorship associations to develop ecosystem talent.

6.1.5 Clear and Public Goals and Measures of Success

It is highly recommended that the Government be clear in both internal and public communications that the objective of all startup ecosystem investments—whether arranged through the proposed National Innovation Fund, as outlined in the Startup Act, or via the recommended semi-autonomous operating entity—is to cultivate new, innovative businesses and to drive economic growth and well-paying employment. It is crucial to track, measure and publish the net economic impact achieved through the VC FoF's investee activities. Suggested measures could be the number of companies invested, jobs created, and patents registered. This will help maintain domestic and international support for the program.

It must also be widely understood that some investment vehicles, such as the Tax Credit Fund, will only be maintained until more permanent solutions are enacted. Similarly, the foundational mandate of the VC FoF must explicitly state that the purpose of the fund is not to deliver profits for the Government or participating donors. Instead, these "first-in" funds serve to reduce risk and increase the fund's attractiveness for subsequent investors by forgoing profits and rating full repayment as a tremendous win. The strategic goal of the VC fund is to sustain itself long enough to drive the ecosystem forward and to successfully spin off or exit the startups it nurtures. In the best case, this would involve either Initial Public Offerings or non-government investors in the fund making major conventional investments in the now successful businesses.

6.1.6 International Precedents

Ignite—National Technology Fund (Pakistan)

- The National Technology Fund was set up as a Section 42 (not-for-profit) company in December 2016, under the Ministry of Information Technology.
- The entity has mainly worked towards building the capacity of entrepreneurs and has funded multiple incubation centers across the country.
- Since the inception of the entity, VC investment in Pakistani tech-enabled startups has increased exponentially.

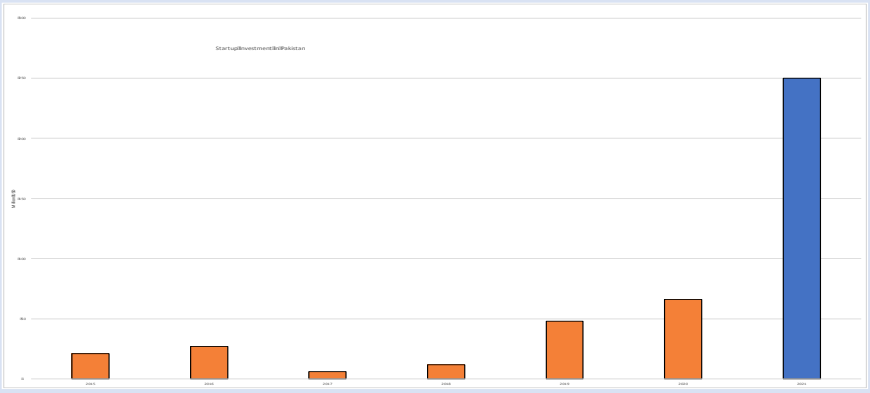


Figure 7 Ignite Pakistan (Bloomberg) [60]

[60] "Maqsad Scores Largest Funding among Pakistan Edtech Startups," BNN Bloomberg, September 20, 2021, https://www.bnnbloomberg.ca/maqsad-scores-largest-funding-among-pakistan-edtech-startups-1.1654532.

Startup India

- A flagship initiative of the government of India, intended to catalyse startup culture and build a strong and inclusive nationwide ecosystem for innovation and entrepreneurship.
- Since its launch in January 2016, Startup India has rolled out several programs designed to support entrepreneurs and transform India from a nation of job seekers into one of job creators.
- The broad scope of Startup India's programs is managed by a dedicated Startup India Team, which reports to the Department for Promotion of Industry and Internal Trade (DPIIT).

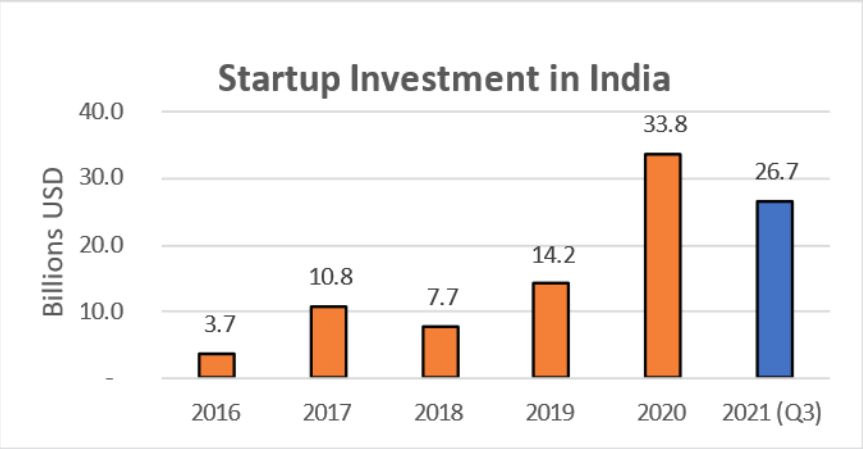


Figure 8 Startup India (PitchBook) [61]

[61] "India's Surge in VC Minting Unicorns at Record Pace," PitchBook, September 20, 2021, https://pitchbook.com/news/articles/2021-india-vc-unicorns-record-pace.

Recommendation: The Government Should Constitute a Semi-Autonomous Operating Entity (SAOE): "Jumpstart Ethiopia"

The entity's core mandate will be to:

- implement and operate the structures and processes to realise the policies of the Government in support of the startup ecosystem,
- ease access to finance bottlenecks for startups,
- foster a nurturing environment for entrepreneurs that includes educational and technical support and facilitation of mentorship,
- act as a one-stop shop for resolving all startup problems and addressing pain points,
- act as a liaison between the industry and the public sector regulators and ministries,
- facilitate the development of enabling policies, and
- promote the ecosystem on the international stage to attract funding and international partnerships.

6.1.7 Recommended Organisational & Reporting Structure for "Jumpstart Ethiopia" Semi-Autonomous Operating Entity:

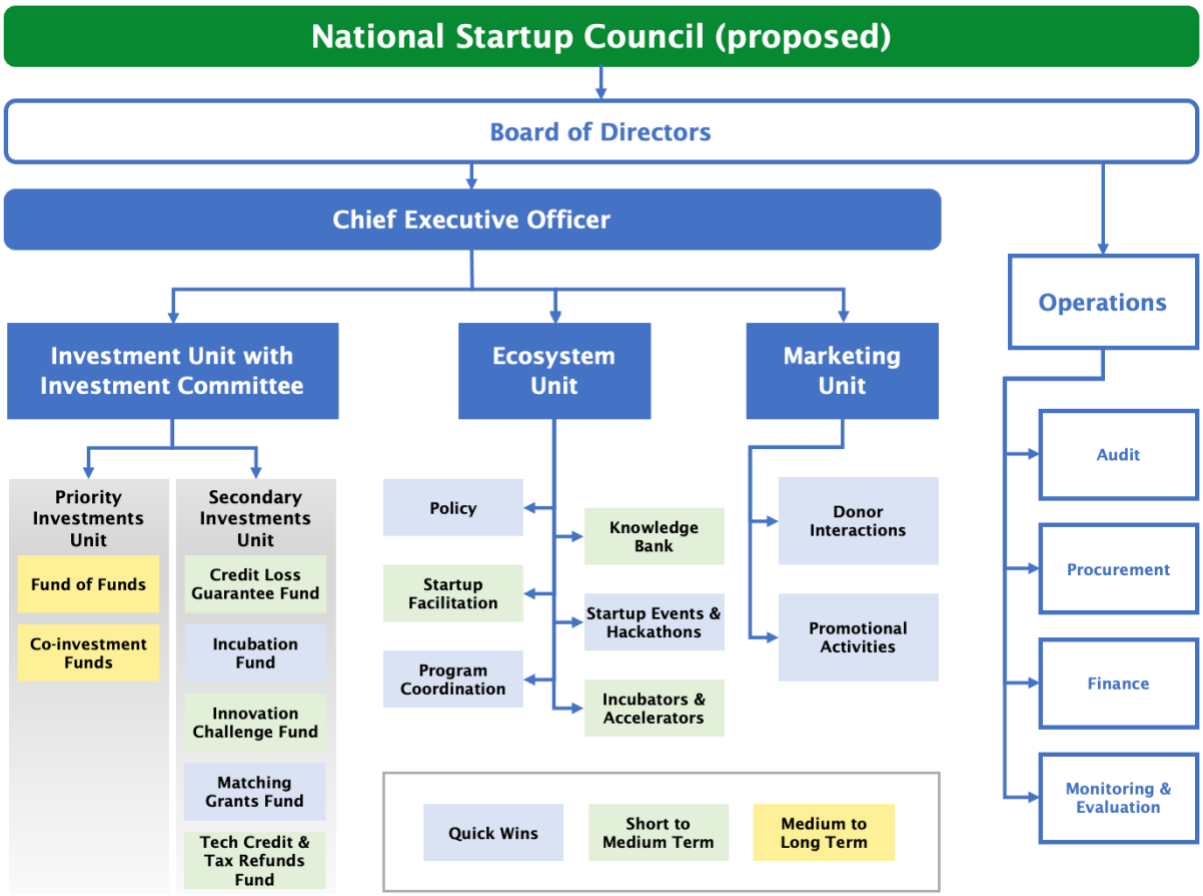


Figure 9 Organisation and Reporting Structure for "Jumpstart Ethiopia" (SAOE) (Digital Financial)

Board of Directors Structure

Chair		
Government Representation (appointed by their minister)	**Regulatory Representatives** (appointed by their agency)	**Private Sector Representatives** (elected by registered entrepreneurs)
• Ministry of Innovation and Technology • Ministry of Trade and Industry • Jobs Creation Commission • Ministry of Revenue • Ministry of Finance • Others	• National Bank of Ethiopia • Ethiopian Communications Authority • Ethiopian Investment Commission • Capital Markets Authority (NBE) • Trade, Practice and Consumer Protection Authority • Ethiopian Intellectual Property Office	• Incubators • Accelerators • Innovative businesses • Startups • Successful entrepreneurs

Table 4 Board of Directors Structure for "Jumpstart Ethiopia" (SAOE) (Digital Financial)

6.2 Investment Unit

The Investment Unit, led by an Investment Committee consisting of senior domestic and international investment experts, will have responsibility for both the Priority Venture Capital Investments and the Secondary Investment funds as detailed below.

6.2.1 Priority Investments Sub-Unit

Reporting to the Investment Committee, this group's mandate will be to implement and operate the venture capital vehicles which will provide early stage investments into digital startups.

6.2.1.1 Summary of Fund Structures and Recommendations

Highly Recommended:
The Establishment of a Venture Capital Fund of Funds (VC FoF)

The advantages of a VC FoF model are internationally recognised and have been demonstrated in several jurisdictions. Such funds, with both analytical and qualitative evaluation of participant VC funds, have consistently shown higher leverage of FDI, higher job creation, net higher returns (across portfolio), more companies benefiting from cross-pollination and ecosystem fostering, and longer residence-time of the invested capital.

Leading development agencies (IFC, USAID, IMF, World Bank and the AfDB) have frequently turned to this model because of its diversified risk, flexible governance, and overall ecosystem development under the proviso that there must be a certain depth of potential investees and sufficient interest in introducing experienced fund managers.[62] A well-documented and publicised first example of the establishment of a VC FoFs in a developing country was in Ghana in 2005 (see Section 6.3.1.1 Case Study: Lessons Learned from Ghana), with a series of subsequent exemplars in Morocco (2017), Egypt (2019) and Tunisia (2019). This is an advised component for any investment-structuring undertaken by the Government.

The costs of establishing a VC FoF are very modest and the potential benefits enormous. Market estimates of the cost to open an office and manage a small portfolio are relatively low. The minimum investment per VC fund ranges from $2.5M USD for seed funds, through to $10M–15M USD for growth-stage funds.

It would be beneficial for the VC FoF to be registered offshore in a jurisdiction that has developed an investment framework (legal, regulatory, taxation and foreign exchange) aimed at accommodating complex VC investment. London, the Netherlands, Delaware, or Mauritius are internationally recognised as preferred locations. This is explored in detail in Section 6.3.1.3: Onshore or Offshore 6.2.1.2. To ensure that the Ethiopian economy obtains maximum benefit from the VC FoF despite this offshore registration, the SAOE should set stringent requirements for knowledge transfer and mentoring and development of local talent.

An internal agreement should also be established, covering:

- a portfolio mix of generalists and sector specialists (e.g., agritech, healthtech), balancing transformative with disruptive investors,
- requirements for skills exchanges, mentoring, and job shadowing to allow domestic investment staff to progress in their professional development with the goal of establishing a knowledgeable investor class in Ethiopia, and
- the baseline concessions acceptable for participation in those funds.

Suggested Initial Capitalisation: $50–65M USD of concessional investment from the Government and/or a donor, first round closed at $150M USD.

	Rwanda	Tunisia (setup phase)	Egypt	Morocco
Date launched	2018	2019	2019	2017

[62] Shanthi Divakaran, Sam Schneider, and Patrick McGinnis, "Ghana Private Equity and Venture Capital Ecosystem Study," Documents & Reports (World Bank, October 2018), https://documents.worldbank.org/curated/en/244861539865691381/pdf/WPS8617.pdf.

	Rwanda	Tunisia (setup phase)	Egypt	Morocco
Structure	**Co-Investment**	**Fund of Funds & Co-Investment**	**Fund of Funds**	
Governance	Investment decision made by investment committee of private sector representatives			
Target Capitalisation	$100M USD (10-Years)	$200M USD (7-Years)	$140M USD (10-Years)	$84M USD (6-Years)
Private sector leverage target (%)	60%	Approx. 50%	64%	50%
Geographic focus	Local, Regional & International*	National	National	National
Jobs and firms targeted	150 Firms. 2,000 direct & 6,000 indirect jobs	450 Firms & 2,800 direct jobs	TBD	200 Firms

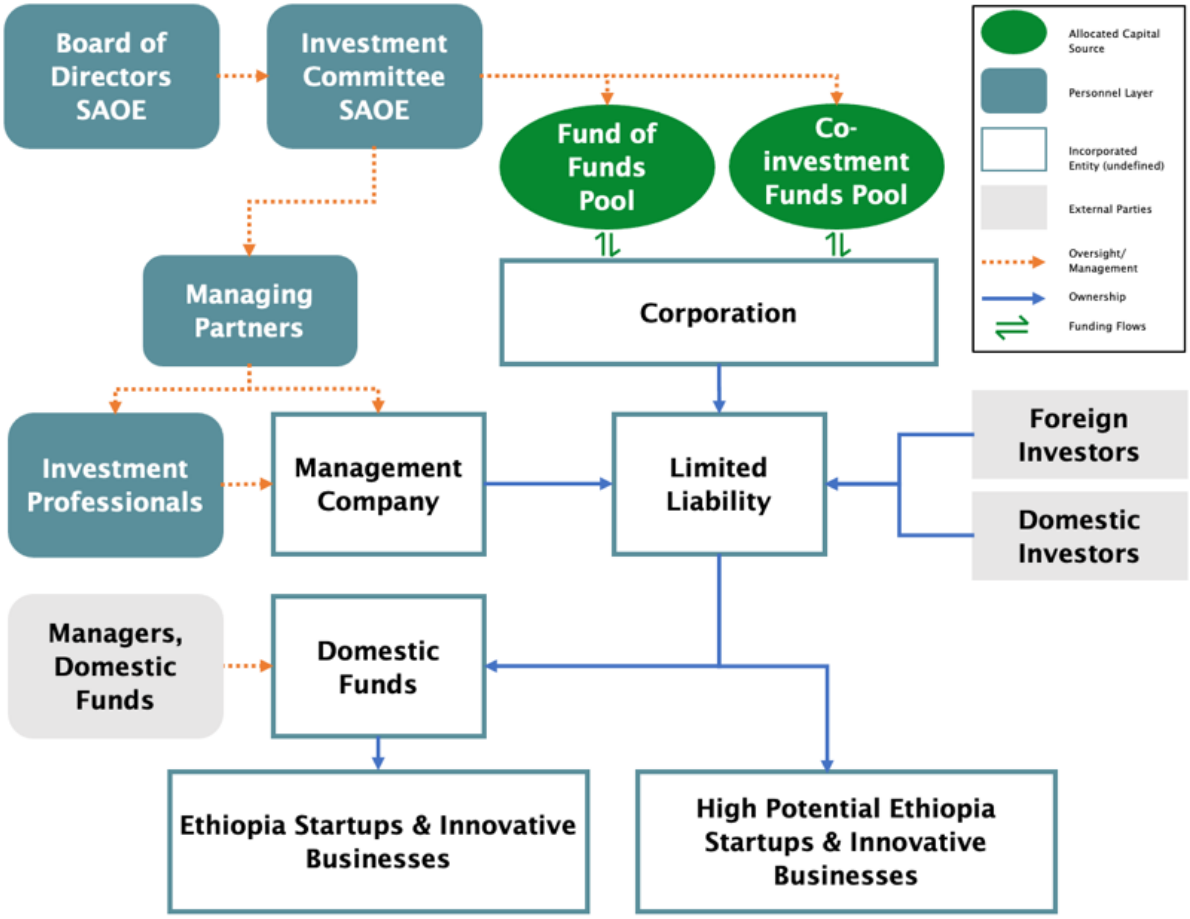
Table 5 Comparison of Fund Capitalisation (Cenfri)

Recommended: The Creation of a Complementary Co-investment Fund

This model allows the priority fund to identify those most promising firms, but without onus of price-discovery or "active" involvement in the investee company. Such funds have several benefits. They enable a compensation tool for the investment professionals at the VC FoF level and signal to the global market that there is additional commitment to the furtherance of well-chosen opportunities, reducing concerns about the orphaning of investments. Once they have established a track record, co-investment professionals may frequently go on to lead new domestic venture capital firms, and thus present the primary means of long-term knowledge transfer to a local VC ecosystem.

Suggested Initial Capitalisation: $35M USD in concessional investment from the Government. It is important that the Government be seen to have a stake in this fund which carries a high risk of losses to create a few very large successes. This fund will attract impact investors and key development institutions which purchase equity, such as IFC.

Structure of Joint Fund of Funds / Co-investment Fund Pools



Not Recommended: The Direct Fund Model

During this early stage of the development of a startup ecosystem, direct venture capital funds have limited impact and frequently become lightning rods for political debate, neither of which are useful to the economy or to the Government. Among the biggest dangers of "going direct" is that of investment capital becoming concentrated in sectors which are "fashionable" or in a small number of startups which are easy to evaluate due to their success in other markets, such as ride-shaping. Moreover, this model exposes the Government to ongoing criticism for having a too-close relationship to the selection and funding processes. This model would only be suitable in situations where specific sectors were unable to source capital for retrofitting or adaptation.

Suggested Capitalisation: $150M USD. This fund would rely almost exclusively on the Government for investment until there were enough proven success to overcome the risk profile. The Tunisian American Enterprise Fund, solely funded by the US government through USAID, had an initial capitalisation of $100M USD in 2013.

Regional Example: Startup Invest, Tunisia

Startup Invest is the investing arm of Smart Capital, the semi-autonomous operator and implementer of the Tunisian startup policy. Startup Invest consists of:

- the Anava Fund (fund of funds) which:
  - is based on a first investment of $45M USD from World Bank, and
  - invests in underlying VC funds managed by private sector investors,
- the InnovaTech Fund (co-investment funds) which:
  - is based on a first investment of $17M USD from World Bank,
  - provides equity and quasi-equity investment in outstanding startups and innovate SMEs through direct co-investment with partner private sector investors,
  - directly funds incubators and accelerators and
  - helps to fund Smart Capital's ecosystem development arm, Flywheel/Startup Empower

	Professional Development	Knowledge Transfer	Ecosystem Development	Public Relations	Political Independence	Job Creation	Financial Return	Sustainability	Net Competitiveness
Fund of Funds	High - Multiple experienced foreign funds hiring for multiple persons	High - Local managers learn through foreign fund team meetings, with exposure to deal-flow activities in other jurisdictions	High - Requirements for participation made under side-letter agreements, and various funds position for future funding potential	Low - In attracting external private markets, this rarely offers large local PR campaigns	High - the selection of underlying firms is managed by the private sector	High - Leveraging foreign capital and selection, this provides the peak point of triggering multiple funds to each invest in multiple firms	Medium - Fund returns are low due to negotiations to attract foreign firms. However, this is partially offset by the highest probability of successes.	High - Foreign funds which have been attracted into and established in the market generally persist for 3 funds (normal life of most fund managers) and leave talented professionals behind.	High - Multiple different sectors stimulated, growth in the ecosystem and attraction of youth into technology all support highest gains in productivity and associated FDI.
Co-investment Fund	Mid - Ability to participate alongside experienced managers	Mid - Sharing of due diligence and monitoring methods, but little exposure to full-cycle Lead through Exit management	Mid - Generally passive position will be showcasing internationally rather than cultivating local engagement	Low - In attracting external private markets, this rarely offers large local PR campaigns, but may signal government support	Mid - Medium risk of political influence emerges from similar dynamic of "championing" in direct funds, but is reduced by private market selection	Low - Medium-term impact on firms but little information on where coinvested capital is spent (i.e. development of an export market)	High - Reliance on private markets to identify, to price, and to manage investments provides highest potential for fund returns.	Medium - Highest returns suggest reinvested capital, but the challenge of attracting future investment does not resolve the ecosystem.	Medium - Private markets advance, and local entrepreneurs identify new potential at-home markets. FDI attraction improves somewhat.
Direct Fund	Low - Experienced managers may provide passive guidance to local hires	Low - Little development of local talent and limited introduction of foreign experiences	Low - Very short-term development, with early years providing excitement but little long-term community	Mid - High immediate attraction of PR, but wanes quickly as capital is deployed.	Low- Significant political risk occurs in the very common selection of "champion" firms and investigations of conflicts relating to them	Mid - Multiple firms are targeted early, so near-term job numbers climb	Low - Lowest returns emerge from the "championing" model with such funds reinvesting in failing enterprises	Low - Personnel rarely remain, PR diminishes, and low returns without accommodating foreign investors make this unattractive.	Low - The "championing" effect, lower returns, and political risks do not generally attract FDI or drive improvements in domestic economy.

Table 6 Summary of Relative Performance of Fund Models (Digital Financial)

6.2.1.2 Discussion: Fund of Funds (FoF)

As suggested by the name,[63] such funds are charged with investment into other managed funds. A FoF strategy need not rely on a specific sector or strategy but can invest in a variety of different fund vehicles including insurers, hedge funds, private equity, and debt funds.

The FoF model is now favoured for jurisdictions that have identified a scarcity of private or private market capital as being a critical hold-up in the growth of a given sector. Concerns about its applicability often arise if there is not some level of existing venture capital network. However, the combination of formal oversight of new hires in-country and of seconded experienced managers creates a cycle of knowledge transfer and investor training which can help such a community take root and prosper domestically.

Instituted transparently, FoFs often leverage 3–4x new FDI and have demonstrated the longevity and benefit of invited funds, with new domestic venture funds frequently seeded from persons trained by these invited funds. They provide a good value proposition for smaller and non-specialist investors, who can leverage the knowledge of the lead investors and the economies of scale provided by the fund structure. A fund of funds also provides swift and simple entry and exit processes for all but the foundational investors.

Investors in this model frequently include a mix of international funders (IFC, IMF, World Bank), development agencies (USAID, AfDB), foundations (Mastercard, BMGF), and domestic partners in the form of pension funds or state-owned enterprises. Some recent leading anchor investors in such funds include Bpifrance, CDC-UK, USAID and the IFC.

[63] "Project Appraisal Document on a Proposed Loan to the Republic of Tunisia for an Innovative Startups and Small And Medium Enterprises Project," Documents & Reports (The World Bank, 2019), https://documents.worldbank.org/curated/pt/853221560823315952/pdf/Tunisia-Innovative-Startups-and-Small-and-Medium-Enterprises-Project.pdf.

Deeper Dive: Yozma Shows the Way

Yozma Shows the Way

Israel's Yozma program is considered the gold standard among government initiatives to promote entrepreneurship. Established in 1993, Yozma invested around $80M USD for a 40% stake in ten new venture capital funds. To further attract foreign investors, the program offered them insurance covering 80% of the downside risk and gave them the option to buy out the government's share at a discount within five years. This option was exercised by eight of the funds. Yozma also set up its own $20M USD fund to invest directly in small companies, eventually growing to $100M USD of commitments. Of its 15 portfolio companies, nine later went public or were taken over (a very high rate of success by VC standards).

Yozma became the catalyst for Israel's now-thriving early-stage startup ecosystem, providing much-needed funding for Israeli companies looking to bring their products to market. In the 1990s, venture capital investments jumped 60-fold from $58M USD to $3.3B USD, with the portfolio of companies increasing from 100 to 800. By 1999, Israel was second only to the U.S. in private equity capital as a share of GDP and 70% of its growth came from high-tech ventures.

Since the advent of Israel's Yozma, the VC fund of funds model has proven a successful market- and evidence-supported method for initiating a vibrant, domestic venture capital market. International examples include:

- Hong Kong, which launched its Applied Research Fund II (ARF II) in 1998,
- Australia, which started its Innovation Investment Fund also in 1998,
- Singapore, which created its Technopreneurship Fund in 1999,
- Brazil, which founded its Inovar Program as an incubator for investment funds in 2000,
- New Zealand, which launched the Venture Investment Fund in 2002,
- Ghana, which constituted its fund of funds in 2005
- Canada, which rolled out the Venture Capital Action Plan in 2013,
- India, which created its fund of funds for Startups in 2016, and
- Tunisia, which debuted its entrant earlier in 2021.

Case Study: Lessons Learned from Ghana

The Venture Capital Trust Fund (VCTF): One of the first African experiences with a FoF model for venture capital development is that of Ghana. The Ghana Venture Capital Trust Fund Act of 2004 created the Venture Capital Trust Fund (VCTF), which was overseen by the Ministry of Finance. The VCTF was funded via a 25% tariff on the National Reconstruction Levy. The National Levy (2001-2007) was a 1.5-1.7 % tax on profits before all other taxes across most companies in the country. This use was within the Levy's mandate to facilitate financing for national development.

The new FoF was constituted with $22.4M USD to invest in domestic VC funds (78%), issue technical assistance grants (9%), and capacity-build new professionals through training. Leading public sector institutions invested including Agricultural Development Bank, Ghana Commercial Bank, National Investment Bank, State Insurance Company, and the Social Security and National Insurance Trust (SSNIT). From the private sector, the co-investors were Fidelity Bank, Gold Coast Securities Ltd, and Ghana Union Insurance. All funds, except for those from Fidelity, had to remain onshore. The FoF was comprised of 5 child or investee funds, managed by domestic fund managers, which invested in 50 local portfolio companies across a required mix of seed, startup, and expansion stages.

According to a final assessment by the World Bank, the VCTF made "significant headway…in paving the road for a domestic private equity and venture capital industry".[64] However, the VCTF's ability to reach its full potential was severely hampered when public pressure led to the repeal of the National Reconstruction Levy. The loss of generous and predictable financing exacerbated design and staffing flaws at VCTF, and the ground-breaking Fund was forced to close early. The last investments in funds took place in 2009 and all elements of the VCTF were wound up by 2014.

Barriers to success: In its review, the World Bank concluded that a few key issues limited the success of the VCTF. The following are of particular interest to the Ethiopian context.

a) The VCTF relied for stability on continuous funding from a source (the National Reconstruction Levy) that was easily subject to political pressure and simple to discontinue. When this funding was removed, investor confidence was shaken, and participation dropped off. Within three years for the funding crisis, the VCTF was unable to consistently cover operational expenses such as legal, accounting, and marketing.

b) The VCTF was subject to management disruption when the government changed in 2008.

[64] Shanthi Divakaran, Sam Schneider, and Patrick McGinnis, "Ghana Private Equity and Venture Capital Ecosystem Study," p. 17 Documents & Reports (World Bank, October 2018), https://documents.worldbank.org/curated/en/244861539865691381/pdf/WPS8617.pdf.

c) The insistence on selecting only domestic fund managers, without an established VC market to draw upon, meant that most managers were inexperienced, while some had competing affinities that channeled focus away from the fund they managed.

d) As the government's commitment to the VCTF waned, the banks became more influential within the investor base and on the investment committees. These bank-based investors lacked knowledge of and experience in VC investing and fell back on the model of underwriting and collecting for loans rather than mentoring and being willing to wait for the emergence of success stories, a few of whom would have covered all of the losses. [65]

Lessons for Ethiopia:

a) The original lump sum investment in the Fund should be of a sufficient size to lower the risk for future investor. This is usually set at 25-30% of the desired capitalisation of the FoF. Startup Tunisia, for example, is starting with a $75M USD infusion from World Bank.[66]

b) The management team of whatever investment structure Ethiopia chooses to pursue (the SAOE and its Fund of Funds or the National Innovation Fund) needs to be cushioned against political changes, external shocks, and public pressure by strong legal contracting.

c) For the core team who will manage all of the child funds, Ethiopia should select the most competent investment managers available and not rely solely on its underdeveloped domestic investment market. Every effort should be made to employ Ethiopian nationals, but only for those positions for which they are fully qualified. Mentoring, skills exchange, and job shadowing should be required by contract amongst all staff to develop domestic investment talent.

d) Ethiopia should ensure that the core private investor base understands the VC investment model and is prepared to be patient and to absorb some losses to participate in the very high returns which successful startups can deliver. This is less of a concern with development institution partners. Organisations such as IFC have firmly established investment criteria and are very sensitive to the lifecycle of the investments in which they participate.

[65] Shanthi Divakaran, Sam Schneider, and Patrick McGinnis, "Ghana Private Equity and Venture Capital Ecosystem Study," Documents & Reports (World Bank, October 2018), https://documents.worldbank.org/curated/en/244861539865691381/pdf/WPS8617.pdf.

[66] "Project Appraisal Document on a Proposed Loan to the Republic of Tunisia for an Innovative Startups and Small And Medium Enterprises Project," Documents & Reports (The World Bank, 2019), https://documents.worldbank.org/curated/pt/853221560823315952/pdf/Tunisia-Innovative-Startups-and-Small-and-Medium-Enterprises-Project.pdf.

Conclusion: Despite its early demise, the Ghanaian Venture Capital Trust Fund proved over the longer run to have been a worthwhile investment in the development of the Ghanese economy. It delivered many benefits for the startup ecosystem, particularly in terms of labour participation and technology acceptance by industry. It also helped acclimate financial institutions to financing the sector. The continued success of the asset class shows that the VCTF delivered a net benefit to the Ghanese economy that has lasted well beyond the fund's life. Today Ghana ranks sixth among nations in Africa for total venture capital and 84th on the Global Startup Ecosystem Index.

Focus on Economic Effectiveness not Investment Returns

Direct returns from a FoF are a much-discussed issue. For a sub-national government or other entity that derives returns from various economic activities (e.g., taxes, levies, licenses), the broad stimulus that comes from ecosystem investment may provide higher overall returns than those that would come from a single fund.

In other words, the distributions of a single FoF entity that is deriving dividends from its investee VC funds may be low, but the net compounding effect of market stimulation from the host of new companies supported by those VC funds may be vast and diffuse throughout the economy. For this reason, many FoF mandates stress that investees focus on stimulating activity in lieu of higher returns—a negotiating dynamic that is reflected in various contractual terms.

Concessions

For the above reasons, governments pursuing a FoF mandate tend to take a flexible negotiating position with funds invited from abroad to make domestic investments. In most cases, they may be willing to forego positions in distributions, return hurdles, or other common fund management terms. These concessions are made under the proviso that investee fund managers will select and grow firms to deliver a net national economic benefit. Thus, some trade-offs are expected, including (but not limited to):

- minimum investment,
- earlier catch-up clauses to fund managers,
- tax alleviation for withholding, sales, VAT, or other activity taxes, and
- lower Limited Partner rights.

Professional investment managers and persons familiar with both VC fund construction and Limited Partner rights can readily navigate these negotiations to ensure an appropriate set of primary goals for the VC fund.

Onshore or Offshore

This report strongly recommends that the VC FoF is constituted as an offshore entity, through one of the jurisdictions which are internationally recognised for their long-established and stable investment policies. The most common of these are: London, the Netherlands, Delaware, or Mauritius. In the case of Ethiopia, the Netherlands would present the least complicated option, as there is a bilateral investment agreement between the two countries.

An offshore arrangement would shield investors and the VC FoF structure from existential challenges such as political interference, slow or limited repatriation of funds, and untested international investment liability laws. Being offshore would also protect against losses which could be incurred from the domestic Ethiopian challenges of foreign exchange, unpredictable taxation, and in flux investment regulations.

Key Risks	Onshore	Offshore
1. Political	Vulnerable to undue local influence and to the lack of policy continuity when governments change or domestic circumstances become perilous.	Suggested jurisdictions have long-established investment policies that have continued despite changes in government.
2. Outflows/ Repatriation Capital Residence Time	Fulfilment of repatriation requests is often slow. Relatively long residence time for capital makes it vulnerable to Ethiopia's high inflation.	In suggested locations, repatriation of funds is consistently faster and more efficient. Capital residence time is lower. As noted above, inflation risk is low. Ease of deal-by-deal transactions limit net capital exposures.
3. Legal	Relies on trust in domestic Ethiopian corporate securities law.	Suggested locations rely on major financial centers' corporate securities law.
4. Liability	Laws, regulations and procedures regarding investor and management liability are unclear, which prompts investor concern.	Suggested locations have known quantifications and limitations of liability on all Principals (e.g., investors, directors, partners, executives).
5. Forex	Regulated by the NBE, thus there is a risk that funds may not be permitted to open an account to receive foreign funds. Forced exposure to the NBE given rate, giving rise to concerns that the forex rate is excessive and costly.	Suggested locations offer many options for exchanging currency including low-cost swaps, which eases the cost of investing.
6. Tax	Ethiopian taxation is dynamic and inconsistently applied in matters of corporate tax, flow-through entities, and capital gains exposure.	Suggested countries have stable, specialised policies that allow them to fairly and consistently address complex taxation needed for such structured entities.
7. Inflation	Higher than average.	Low across primary offshore jurisdictions.
8. Executive/ Individual treatment	Protectionist practices create different treatment classes (citizen, diaspora, foreigner) in matters of taxation, accessibility, and ownership.	Suggested jurisdictions strive to treat all persons equally in matters of taxation, accessibility, and ownership.
OVERALL	Ethiopia specific risks are challenging for investors to measure. It may be easier for Ethiopian investors and investment managers to participate in an onshore structure.	Suggested offshore jurisdiction present familiar and quantified risk profiles. Less "friction" for buying in, trading and selling out encourages higher foreign investment.

Table 6 Onshore Versus Offshore (Digital Financial)

Structure of a Fund of Funds

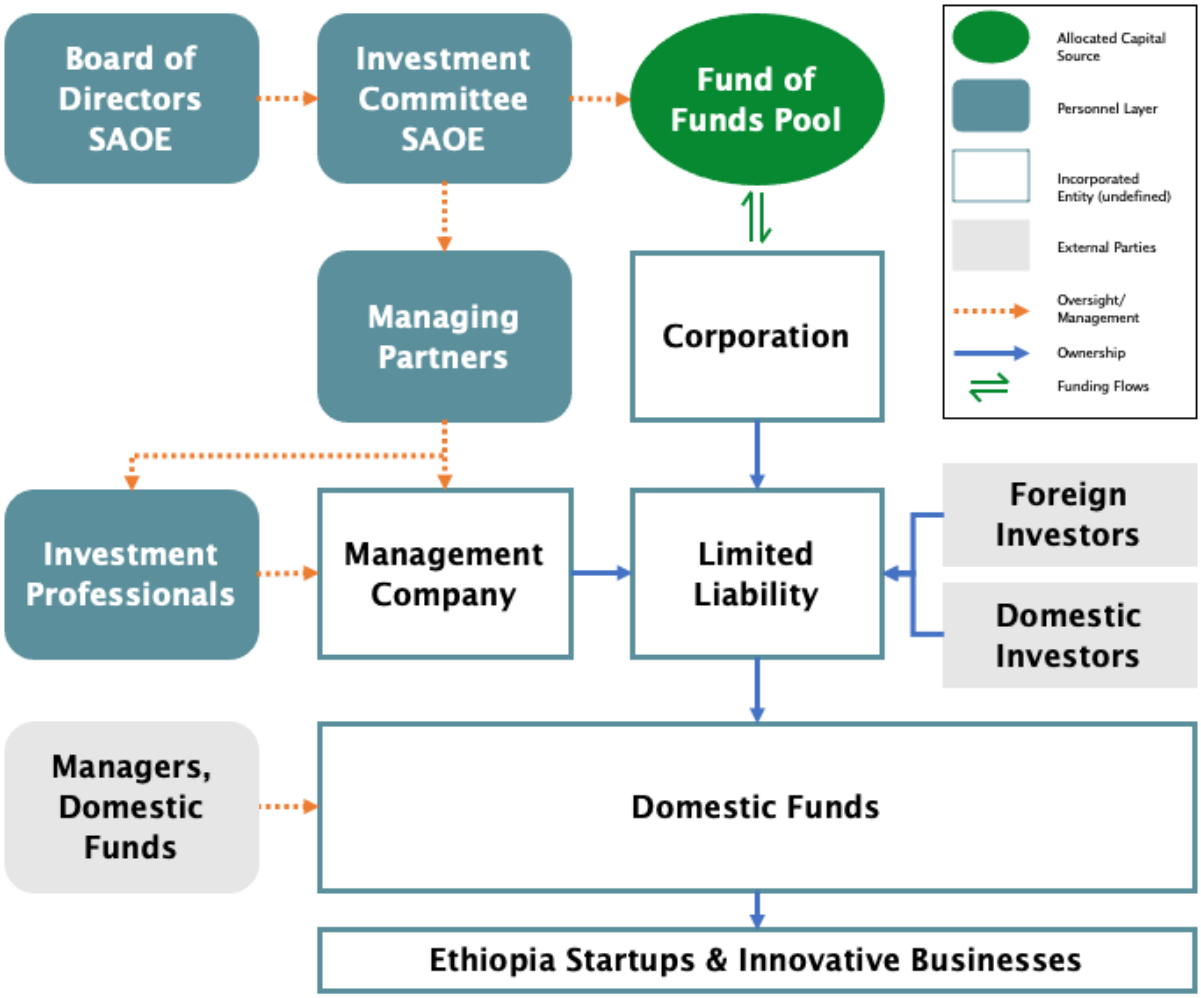


Figure 10 Sample Structure of a Fund of Funds (Digital Financial)

- **Managers, Domestic Fund(s)**: Professionals from both the local market and from foreign funds are paid via the fees assessed by invested venture capital funds.
- **Offshore or Onshore Corporation**: An entity incorporated at arm's-length from the appointed Government ministry (recommended: Finance, to ensure accounting and capital/account management), by which available raised or endowed capital is held for capital calls. It is recommended that the corporation be constituted offshore for the reasons previously discussed.
- **Management Company—Limited Liability:** The prevalent model internationally for fund management is a dyad consisting of:
  - a "limited partnership", which is a limited liability entity into which investors, foreign and domestic, subscribe to flow-through units and assume negligible risk beyond disbursed/invested capital, and

  - a "management company", typically constituted as a "general partner", which assumes much of the operational risk of the overall entity. Management fees are assessed against the Limited Partnership on a negotiated schedule and support the General Partner over the fund life, often with a diminishing fee schedule after the investment term of the fund.

- **Investors**: Foreign and domestic investors may be invited to participate in this model, and frequently an offshore holding entity may be constituted to hold foreign investors' commitments and obligations; given certain structural constraints around forex and minimum investment criteria, this may be required for attracting foreign funds. A "Master LP" agreement is frequently designed to ensure that all funds are equally managed without preference and that investor participation is aligned. In this model, the personnel of the Management Company (General Partner) will be charged with future fundraising activities and structuring.
- **Managing Partners and Investment Professionals**: A mixed selection of managers and investment professionals is advised. In the Ethiopian context, there exist very few experienced local investment professionals, as reflected by the limited venture capital market. Knowledge transfer from foreign professionals with the priority selection of eligible candidates from both public and private sectors should be a key goal. The size of the team is a function of the capitalisation requirements. Taking the example of a $80M USD fund, the typical team will consist of 4–5 professionals: Managing Partners, Partners, Analysts, and a Business Development/PR Officer.
- **Investment Committee (SAOE)**: The constitution of an investment committee of persons without direct affiliation, but properly incentivised, is advised. The process of reporting to and seeking approval from an Investment Committee forces the Managing Partners and Partners to propose, to defend, and to monitor and report on investments on an ongoing basis. Experience suggests that Investment Committees of as few as three can sufficiently challenge the Partners, provided the committee members are suitably removed from the local market, have views on international exports, and have deep experience and understanding of the venture capital market.
- **Board of Directors (SAOE)**: To ensure actions are consistent with the overall mandate of the FoF, an oversight committee – in this case the Board of Directors of the "Jumpstart Ethiopia" SAOE – is strongly advised, with between triennial and biennial meeting schedules to receive updates on the progress, decisions, selections, and key performance indicators of the FoF mandate, such as capital deployed, invested funds, companies invested, persons employed by such companies (and on a pro-rated basis), and new FDI attracted domestically. Generally, an oversight committee operates best with a combination of critical governmental and regulatory personnel, ecosystem partners, and previously successful entrepreneurs. This balances interests and broadens the capacity for proper oversight to encompass the stakeholder groups.

6.2.1.3 Discussion: Co-investment Fund

Co-investment funds make minority investments alongside other fund managers or VC firms. By avoiding the lead position and generally waiting for the second investment round, a co-investment fund escapes both the management costs and high risk of being a first-in investor.

A stand-alone co-investment fund is not recommended in the current Ethiopian context as:

- co-investments need attention from foreign or domestic investors already in the market. Moreover, the reliance on collaborating with investors but without facing price-discovery risks helps develop some talent in monitoring but little in any of sourcing, identification, direct management or exiting from opportunities.
- attraction of foreign direct capital also requires a process for permitting inflows of capital that may fall below the current thresholds allowed under Ethiopian law.
- these models seldom promote very early-stage growth, stimulate the ecosystem, or encourage new entrepreneurship.

However, a co-investment fund can enable FoF investors to create a pool of capital reserved for investments in exceptional opportunities. Such funds are a common tool for FoF managers to achieve a more linear return on total capital deployed and to support the FoF's objective of fostering tangible growth in underlying company assets and offsetting losses incurred in the diminished position of the FoF in its distributions.

An Ethiopian example could proceed as follows:

- A highly reputable impact investor—such as the IFC, GIZ or Investisseurs & Partenaires—or a VC already vetted by and participating within the "Jumpstart Ethiopia" VC FoF, identifies and plans to invest in (an) Ethiopian venture(s) that may or may not already be represented within the investments domiciled under the VC FoF.
- The "Jumpstart Ethiopia" VC FoF investment team assesses the deal for alignment to their mandate and investment criteria and finds it compatible.
- "Jumpstart Ethiopia" may choose to participate in the funding round without taking the lead position and incurring the management costs. These funds are allocated out of a co-investment fund which invests on the same terms as the price-discovering VC fund manager.

Structure of a Co-Investment Fund

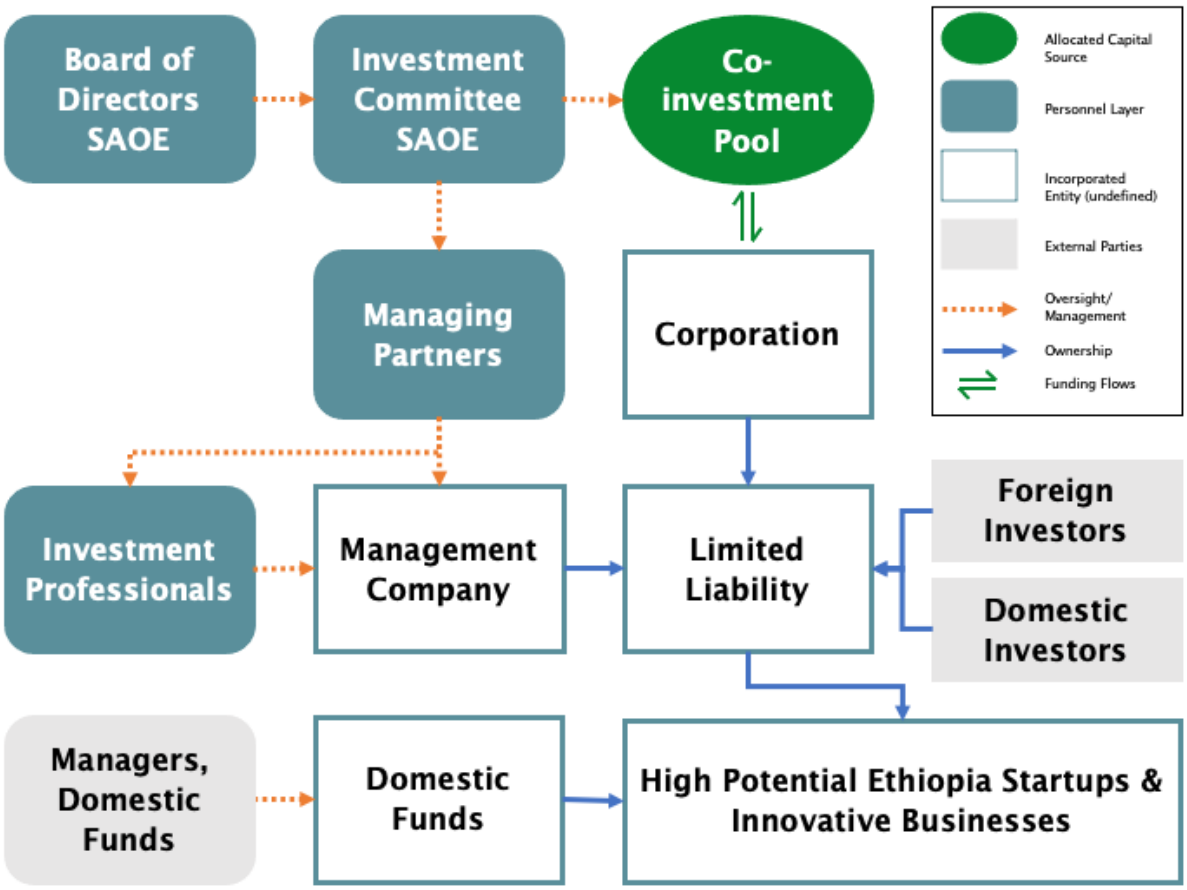


Figure 11 Sample Structure of a Co-Investment Fund (Digital Financial)

- **Managers, Domestic Fund(s)** Professionals from both within the local market and some from foreign funds are paid via the fees assessed by invested venture capital funds.
- **Onshore or Offshore Corporation**: An entity incorporated at arm's-length from the appointed Government ministry (recommended: Finance, to ensure accounting and capital/account management), into which available raised or endowed capital is held for capital calls. It is recommended that the corporation be constituted offshore for the reasons previously discussed.
- **Management Company—Limited Liability**: The prevalent model internationally for fund management is a dyad consisting of:
  - a "limited partnership", which is a limited liability entity through which investors, foreign and domestic, subscribe to flow-through units and assume negligible risk beyond disbursed/invested capital, and
  - a "management company", typically constituted as a "general partner", which assumes most of the operational risks of the overall entity. Management fees are

assessed against the Limited Partnership on a negotiated schedule and support the General Partner over the fund life, often with diminishing fee schedule after the investment term of the fund.

- **Investors:** The intention of the co-investment fund is to support returns for the FoF itself. Foreign and domestic investors, external to the FoF investment group, may be invited to participate in this model, but frequently do not as there are costs involved in being a passive participant. The most likely external domestic investors are large private and public firms for which there may be passive value in supporting innovations in their entrenched sectors (e.g., utilities, banks, pensions funds). Regional and global foundations (MasterCard, BMGF) and impact investor and development organisations (IFC) often support these sorts of specialised investments by putting up funds with concessional terms.
- **Managing Partners and Investment Professionals**: The teams selecting co-investment candidates are made more effective when they include those with the local unofficial knowledge that is available to domestic specialists. In Ethiopia, where capacity building is a key goal, these teams should be deliberately structured to allow domestic staff of the VC FoF and secondary investment funds to work closely with the international experts at all levels of decision-making, including during the selection of co-investment candidates. It may be valuable for the Investment Unit to onboard two additional Sr. Associates/Partners to ensure that knowledge transfer is not sacrificed to expediency.
- **Investment Committee (SAOE)**: As for a fund of funds, above. The constitution of an investment committee of persons without direct affiliation, but properly incentivised, is advised. The process of reporting to and seeking approval from an Investment Committee forces the Managing Partners and Partners to propose, to defend, and to monitor and report on investments on an ongoing basis. Experience suggests that Investment Committees of as few as three can sufficiently challenge the Partners, provided the committee members are suitably removed from the local market, have views on international exports, and have deep experience and understanding of the venture capital market.
- **Board of Directors (SAOE)**: Whereas sufficient distance often exists between the advised persons on this oversight committee – in this case the Board of Directors of the "Jumpstart Ethiopia" SAOE - at the VC FoF level, following each co-investment proposal and before the next Board meeting, the Management Team should seek conflict of interest disclosures from the Board membership to ensure arm's-length oversight is maintained.

6.2.1.4 Discussion: Direct Venture Capital Fund – Not Recommended for Ethiopia at the Time

In the direct venture capital fund model, an arm's-length entity is formed by a designated division of the Government and charged with the:

- selection of eligible investee opportunities,
- negotiation of terms with targets,
- management of the investments through the full investment cycle, and
- divestiture of the assets at a liquidity event.

Experience has demonstrated that government direct venture capital funds rarely perform as well as their private-sector counterparts. Relationships between state-backed direct venture funds, government leaders, high-ranking civil servants, and other prominent individuals frequently lead to the politicisation of the investment decisions. Conflict-of-interest and disclosure protocols generally fail to catch the full extent of influence in such allocations.

Pressure from these relationships creates capital inefficiencies throughout the investment cycle. At the earliest stages, it may lead to support for enterprises that do not completely fulfil the fund's investment mandate, while in the middle to latter stages, government-backed funds tend to persist in supporting stagnated but well-connected firms that independent, private investors would abandon.[67] Carefully structured outsourcing may succeed in addressing the issues of undue influence, but these efforts frequently lead to principal-agent misalignment, excessive transaction costs, and inordinately lengthy processes.

In addition, direct funds are eventually obliged to play the role of "Lead Investor", upon whom the general market relies for reasonable and acceptable price-discovery of the company's securities. This can result in non-financial and non-technical metrics coming to dominate both public and private investment decisions and causing distortions throughout the developing ecosystem. Collectively, the price risk, political risk, and personnel risks culminate in the greatest risk: that of concentration in the portfolio.

In well-supervised investment environments, the conflict-of-interest rules which limit undue influence create a different challenge. In these markets, government-backed entities are often restricted from marketing their investees' products and services directly to the government or to other government-backed entities. They may even be excluded from open bidding processes. These restrictions create another form of market distortion and

[67] Erik Engberg, Patrik Gustavsson Tingvall, and Daniel Halvarsson, "Direct and Indirect Effects of Private- and Government-Sponsored Venture Capital," *Empirical Economics* 60, no. 2 (2019): pp. 701-735, https://doi.org/10.1007/s00181-019-01770-w.

may cause the market to undervalue the startups, thereby weakening their ability to successfully exit the support of the fund.[68]

"With relatively few exceptions, [direct government venture capital fund] activity has not been successful".[69] Of the few successful examples, the most prominent are within the UK's 3i and Israel's Yozma programs. Both cases relied on the exceptional research capacity of their domestic universities, the domestic availability of experienced technical professionals, a robust regulatory and supervisory environment with independent watchdogs and a visible and politically supported timeline toward privatisation.[70]

In summary, it is difficult to see how this structure would be successful in addressing the development of a digital startup ecosystem in the Ethiopian context.

Structure of a Direct Venture Capital Fund

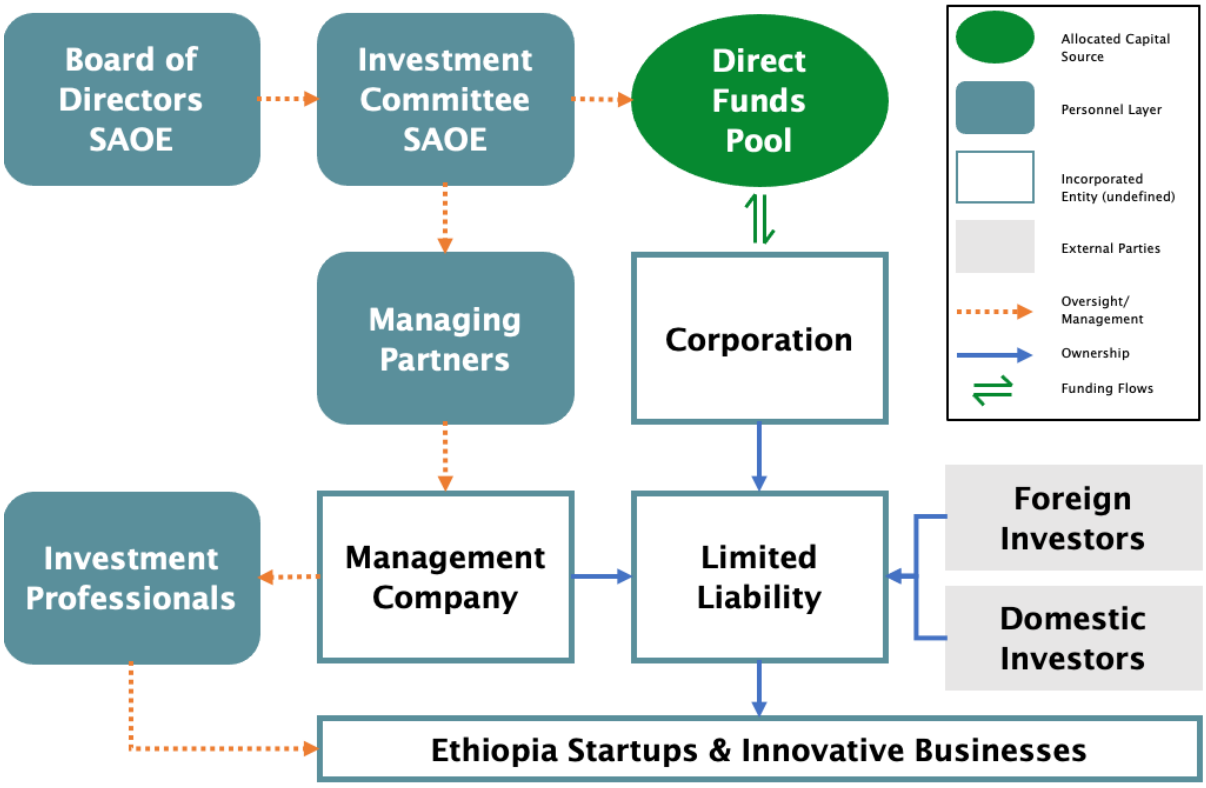


Figure 12 Sample Structure of a Direct Venture Capital Fund (Digital Financial)

[68] Engberg et al., 2019.

[69] Gordon C. Murray and David C. Lingelbach, "Twelve Meditations on Venture Capital: Some Heretical Observations on the Dissonance between Theory and Practice When Applied to Public/Private Collaborations on Entrepreneurial Finance Policy," SSRN, November 11, 2009, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1502643.

[70] Gil Avnimelech, Martin Kenney, and Morris Teubal, "Building Venture Capital Industries: Understanding the U.S. and Israeli Experiences," SSRN, April 4, 2016, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2758198 & Murray and Lingelback, 2009.

- **Onshore Corporation**: An entity incorporated at arm's-length from the appointed government ministry (recommended: Finance, to ensure accounting and capital/account management), into which available raised or endowed capital is held for capital calls.
- **Management Company—Limited Liability:** As with prior models, the prevalent model consists of:
    - a "limited partnership"—a limited liability entity into which investors, foreign and domestic, subscribe to flow-through units and assume negligible risk beyond disbursed/invested capital, and
    - a "management company" that is typically constituted as a "general partner" which assumes much of the operational risks of the overall entity.
- **Investors:** Foreign and domestic investors may be invited to participate in this model, and frequently a mix of both do. The obligations for fundraising may be shared between the constituting government offices and the appointed/selected management team.
- **Managing Partners and Investment Professionals**: Successful direct investment requires strong technical knowledge of startup valuation and management as these professionals are responsible for the selection, management guidance, and exiting or "re-upping" of the target companies. In the Ethiopian context, this would mean substantial investment in international talent to bolster the available local expertise.
- **Investment Committee (SAOE):** As for fund of funds and co-investment funds above. The constitution of an investment committee of persons without direct affiliation, but properly incentivised, is advised. The process of reporting to and seeking approval from an Investment Committee forces the Managing Partners and Partners to propose, to defend, and to monitor and report on investments on an ongoing basis. Experience suggests that Investment Committees of as few as three can sufficiently challenge the Partners, provided the committee members are suitably removed from the local market, have views on international exports, and have deep experience and understanding of the venture capital market.
- **Board of Directors (SAOE)**: As is the case with Co-Investment Funds, appropriate care must be taken to ensure that conflicts of interest within the oversight committee – in this case the Board of Directors of the "Jumpstart Ethiopia" SAOE – are avoided.

6.2.2 Secondary Investments Sub-Unit

This group's main mandate will be to implement and operate a selection of smaller funds that would directly support the digital startup ecosystem and help to quickly address several roadblocks to success identified by stakeholders during the consultant interviews. These are **concessional funds;** in that they will disperse more capital than can be replaced by investment gains. Their goal is to amplify the impact of their capital through the greater ecosystem effect of their targeted support and, secondarily, through proficient investment.

Some of these funds offer foundational types of support that will remain necessary through many startup cycles. Others, such as the Tax Credit Fund, should be disbanded as soon as the appropriate changes can be made to the operating and investment environment to render them unnecessary. As noted above, these secondary funds are not dissimilar to those suggested by the Startup Act, although there are key differences in their management and oversight structure.

Skilled, ethical, and independent management is as important to these smaller funds as it is to the VC FoF. In fact, because the actions and results of these funds will be easily visible within the wider startup and donor communities, impartiality and adherence to rules is of paramount importance.

6.2.2.1 Tech Credits Fund—Quick Win (Impact Seen Within 3-6 Months), Ongoing Deployment

Startups are increasingly using plug & play Software as a Service (SaaS) platforms to run their day-to-day businesses, including to manage operations, optimise marketing and grow the supply side of the business. These services allow companies to scale up operations quickly, with no or very little capital investment. They can, however, add up to significant monthly operating expenses, especially as a startup looks to expand its staff and needs to purchase more user licences.

A non-exhaustive list of SaaS services which should qualify for reimbursement can include:

- cloud servers and storage (Amazon Web Services, Google Cloud, Microsoft Azure, Sun Data World),
- digital aggregators (Segment, Hootsuite, HubSpot),
- customer relationship management (CRM) tools (Salesforce, Zoho),
- customer service tools (Intercom, Freshchat),
- accounting Services (QuickBooks, ProfitBooks),
- social media platforms (Facebook, Google, Instagram, TikTok),
- tech team management (Codebase, Basecamp),
- SMS, One Time Pin (OTP) (Google),
- communication services (WhatsApp for Business, Slack), and
- Internet Service Providers (ISPs).

Many providers, including Segment, Google, Zendesk, and others, offer additional discounts to businesses that are registered with an incubator, accelerator, or other verifiable startup support program. These discounts will help to stretch the fund's resources. This model of providing free credits to startups is employed to good effect by major accelerators and incubators all over the globe and it is recommended that the SAOE "Jumpstart Ethiopia" register for these programs and assist the startups to access them.

6.2.2.2 Tax Refunds Fund—Quick Win (Impact Seen Within 3-6 Months), Short Term Deployment

Many of the public and private sector stakeholders interviewed for this Note reported that the current Ethiopian tax system, which does not differentiate between emerging and established businesses, often hampers early-stage startups. Tax incentives of the sort planned in the Startup Act are well-established and effective ways for governments to support the development of specific sectors or geographies, or to support businesses of certain sizes or stages.

Other changes to legislation will be required if the Government is to consider offering special incentives to startups. A quick alternative would be for the semi-autonomous operating entity to reimburse startups for any taxes and other similar fees paid during their growth stage. Startups will still be required to pay their taxes and fees as per regulatory requirements. Eligible firms can then submit their receipts to the "Jumpstart Ethiopia" SAOE for review. The entity can then review the status of each and reimburse those firms that meet requirements. This fund should be considered a short-term solution only and should have a clear requirement to close 12 months after the necessary tax code adjustments have been enacted.

6.2.2.3 Innovation Challenge Funds—Quick Win (Impact Seen Within 3-6 Months), Ongoing Deployment

Innovation challenge funds allocate monies to foster and incentivise creative competitions such as hackathons, impact challenges, and VC pitch contests. The Innovation Challenge Fund would support events hosted by accredited incubators and accelerators as well as those managed by the SAOE's Ecosystem Unit. Challenge funds are most effective when geared toward specific objectives—such as extending financial services to the poor; solving a specific health problem through digital platforms; stimulating innovation in the more effective use of agricultural resources; or increasing literacy and numeracy through learning games, for example. By having clear goals and parameters, these funds can engage donors with focused mandates, achieve clearly measurable results, and attract communities of supporters who share their objectives. The creation of a selection of smaller capital pools, run by a single investment team, would allow Ethiopia to efficiently incentivise its startups and innovative businesses to create solutions to problems which are on the national agenda. The Innovation Challenge Fund should be run separately from all other funds.

6.2.2.4 Credit Loss Guarantee Fund—Quick Win (Impact Seen Within 3-6 Months), Medium Term Deployment

The Credit Loss Guarantee Fund should be structured differently and invested separately than the other funds envisioned, as its investment strategy must consider the need to provide monies on demand to cover loan defaults, which are hard to accurately predict for small firms. This unpredictability of failure is particularly acute in economies such as Ethiopia where many businesses are founded using informal loans, which may need to be repaid swiftly for personal reasons. This fund could start out quite small but would need to be recapitalised if there was a sharp increase in formal lending to startups, or a wide-spread economic crisis. This would offer a low-risk way for The Government to promote the flow of venture debt from the formal financial institutions to startups, since the semi-autonomous operating entity will only be obliged to step in when a given startup was unable to repay the loan.

The amount of credit loss covered by this fund should be adjusted as the financial sector becomes more adept at evaluating startups. This is to avoid lenders becoming lax in their due diligence because they can rely on the fund to cover losses.

6.2.2.5 Incubation Fund—Impact Seen in 6-18 months,

As previously discussed, the small number of fully functioning Ethiopian incubators and accelerators are concentrated in Addis Ababa. Incubation facilities typically offer fledgling companies physical infrastructure, mentorship support and advice, access to networks, access to market, etc.

The most costly of these offerings is physical infrastructure, which requires large up-front investment along with monthly payments for rent and operations. As a result, opening and running an incubator might not be a financially viable option for the private sector in the long run. This is where the Incubation Fund comes in.

To promote entrepreneurship and train a new generation of business leaders, the Incubation Fund will work with various private entities to run generic and specialised cohorts around the country (including tier 2 & tier 3 cities) that will nurture innovation and innovators across Ethiopia.

Importantly, this approach will help reduce the gap between the support available to entrepreneurs in the capital and startups in smaller centres and extend the opportunities and benefits of a nurturing startup ecosystem to a wider population.

6.2.2.6 Matching Grants Fund—Impact Seen in 6-18 Months, Ongoing Deployment

Matching grants are used widely by governments around the world to increase investments in their startup ecosystems. This special purpose fund would provide monies to match donor grants, bequests, or gifts. More importantly, the fund could be mandated to match investments from non-profit organisations and/or community investors, thereby helping to de-risk these positions. The fund would also match monies from completive grant programs run by regional and urban governments and professional organisations.

6.2.3 Capitalisation, Fund Life Cycle, & Funding Partners

This report has touched on the topics of capitalisation, fund life cycle and sustainability, likely funding partners, and sources of external assistance in other sections. Given their importance to the creation of a robust startup ecosystem, however, it behoves us to address each in more detail.

6.2.3.1 Venture Capital Fund of Funds

A venture capital fund of funds established for the purpose of stimulating the growth and success of startups in a developing economy is a high-risk operation and will need initial or foundational investors that are willing to use their contribution to decrease the risk profile in order to attract international investors. In other words, the Government should not expect to profit directly from this investment, even though private investors may. The Government still stands to reap ample rewards, both from resulting gains in the economy and from increased investment flows.

This is borne out by examples in other countries. In the case of the Tunisian Anava FoF, the World Bank expects to leverage $45M USD into more than $100M USD of invested capital. Jordan's Innovative Startups and SMEs Fund (ISSF) founded in 2017 with a $50M USD World Bank loan, now has a capitalisation of $98M USD, with $36.54M USD of private capital coming from 26 global, regional and local investors.

Considering the much larger potential market in Ethiopia, the Government could reasonably expect to see $60M–100M USD of new VC capital invested into the VC FoF in return for risking $50M USD with no expectation of gains. Initial concessional capitalisation used for similar ecosystem-building funds elsewhere in the world has ranged from $30M USD to $50M USD. These examples support the recommendation above that the Government should look to commit between $50M–65M USD to quickly launch the VC Fund.

It is important for the Government to accept that the goal of the VC FoF is to invest in and successfully exit—via IPO or sale of its stake to wholly private investors—as many digital startups as possible. The Fund should not be viewed as a funding source for specialised support for the startup ecosystem. Ideally, the "JumpStart Ethiopia" VC FoF should not last beyond two rounds of investment lasting seven to ten years each. Ideally the Fund would be graduating the most precocious of its first round of startups within four to five years. By the ten-year mark, the success or failure of the program will be abundantly clear.

6.2.3.2 Co-Investment Fund

The co-investment fund should be considered as a vehicle to supercharge the most promising startups with investment beyond that of the VC FoF.

The Angaza Innovation Fund (Rwanda), which will operate without the support of a collaborative FoF, has a target size of $100M USD. A founding loan of $30M USD from the African Development Bank (AfDB) will be matched by an equal contribution from the privately owned regional General Partner fund manager. African Development Bank and Angaza expect a further $40M USD to come from unaffiliated private investors, for a total amount of $100M USD in direct commitments. The project has a 10-year life cycle and is expected to generate up to $300M USD in follow-on investments.[71] The difficulty of capitalising such a large co-investment vehicle is shown by the many delays that the Rwanda project has faced.

In Ethiopia, the co-investment fund can be more modest to start, as it is not intended to be the main source of startup capital. $35M USD put forward by the Government and a partner lender would be enough to make a considerable impact, propelling the highest potential innovative enterprises past the venture capital stage.[72] This fund could have a long life cycle, potentially two decades or more, with the Government and the development agencies scaling back their respective shares as the investment team gains experience and the Ethiopia startup ecosystem starts to produce the kinds of proven internationally competitive winners that will entice investment without external stimulus.

IFC, with its mandate to invest in promising enterprises to help to build more robust economies and sectors, would be an ideal partner in this fund. IFC is heavily committed to partnering with funds to promote SME growth in developing nations."[73] European Investment Bank, Cassa Depositi e Prestiti, and KfW Development Bank are other development organisations already active in similar development programs in the regions, and thus could also make promising partners.[74]

6.2.3.3 Ecosystem Funds

The special purpose ecosystem funds—the Tech Credits Fund, Tax Refunds Fund, Innovation Challenge Fund, Credit Loss Guarantee Fund, Incubation Fund and Matching Grants Fund—should be financed separately from the venture capital fund, as they each have a unique risk profile and expected pay-out flow. The Tunisian example, which aims to support a much smaller potential population of startups, has set up the InnovaTech group of funds based on a first investment of $17M USD from World Bank, to **both** co-invest and

[71] "Rwanda Innovation Fund," African Development Bank Group, May 22, 2019, https://www.afdb.org/en/Projects%20%26%20Operations%20%281166%29%2C%20Project%20Appraisal%20Reports%20%281183%29.

[72] Emmanuel Ntirenganya, "Pac Grills Finance Ministry Officials over Delayed Projects," The New Times - Rwanda, September 28, 2021, https://www.newtimes.co.rw/news/pac-grills-finance-ministry-officials-over-delayed-projects.

[73] "IFC's Priorities in Funds," ifc.org, accessed October 4, 2021, https://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/funds/priorities/priorities.

[74] "G7 Development Finance Institutions and Multilateral Partners to Invest over $80B USD into African Businesses over the next Five YearsJ," African Private Equity and Venture Capital Association, June 2021, https://www.avca-africa.org/newsroom/member-news/2021/g7-development-finance-institutions-and-multilateral-partners-to-invest-over-80-billion-into-african-businesses-over-the-next-five-years/.

support the ecosystem. While it is impossible to precisely pinpoint the amounts that will be needed for each of the ecosystem funds without significant research in cooperation with the Ministry of Finance and in-country incubators and accelerators, it is recommended that the Government reserve $15M USD for this part of the program. The lifespans of these funds would run from about two years for the Tax Credit Fund, which should only exist until startup-friendly adjustments to tax policy are fully implemented, to the Innovation Challenge Fund, which should persist in perpetuity.

It is reasonable to expect that specialised donors would be willing to support these funds. Organisations such as the British Council, the Indigo Trust, UNCDF, and Mastercard Foundation[75] are already actively funding incubators and may be willing to coordinate with the "Jumpstart Ethiopia" Ecosystem Unit and the complementary Incubation Fund. Visa, through the Visa Everywhere Initiative, has in fact already sponsored an innovation challenge in Ethiopia and would thus be a natural partner for the "Jumpstart Ethiopia" Innovation Challenge Fund.[76]

6.3 Ecosystem Unit

Headed by the Ecosystem Director, this unit will be responsible for identifying and championing policy interventions, facilitating startup support, and creating a sense of community among the founders and staff of startups and innovative businesses. We would recommend that these functions sit under the umbrella of the semi-autonomous operating entity, so that they are seen as independent enough to legitimately represent the private sector entrepreneurs and the incubators and accelerators that have private funding. This division would allow the Ministry of Innovation & Technology to freely champion the Government's agenda and to act as a coordinating force within the public sector community of ministries and regulatory bodies. The suggested division should assign to MInT the position of touchpoint for any large-scale international development programs arranged directly with the Government. Conversely, there may arise situations in which the Ecosystem Unit can build bridges to investment and knowledge-sharing communities who, due to political or stability concerns, would be hesitant to directly engage with any government ministry. While the level of independence varies, programs ranging from Chile's wholly government funded CORFO/Start-Up Chile to Israel's Yozma through to the newly formed Smart Capital Tunisia have proven the value of an empowered, decision-making operating entity focused solely on the startup ecosystem.

[75] "Ethiopia's Digital Economy," Cepheus Growth Capital Partners, accessed October 3, 2021, https://cepheuscapital.com/wp-content/uploads/2019/01/Ethiopias-Digital-Economy.pdf.

[76] "Arifpay Emerges Winner of Visa Everywhere Initiative 2021 in Ethiopia," Visa, July 2021, https://africa.visa.com/visa-everywhere/blog/bdp/2021/07/15/arifpay-emerges-winner-1626326589255.html.

6.3.1 Startup Facilitation & Coordination of Programs— Quick Win (Impact Seen Within 3-6 Months), Ongoing Program

The Startup Facilitation Centre will be the first line of support for startups across Ethiopia and will help promising new firms to get their products and services to market quickly by helping founders to overcome administrative hurdles so they can focus on their businesses. The activities performed by the centre will include:

1 offering subject matter expertise in collaboration with relevant associations (i.e., fintech association, ICT associations),

2 helping local entrepreneurs, foreign investors, and members of the overseas diaspora to set up businesses,

3 providing startups and aspiring entrepreneurs with information related to existing rules, procedures, and processes,

4 matching startups with appropriate incubators or accelerators, based on sector, location, and phase of development and

5 delivering a "one-stop" service to help startups understand how to best organise to apply for and use more than one program of support.

An Ethiopian example could proceed as follows:

- A woman-founded startup that creates a monitoring system and app to make the storage and use of solar or wind power more efficient may be eligible for a grant from the Global Energy Efficiency and Renewable Energy Fund, a UN sponsored fund of funds that invests in clean energy infrastructure in developing countries.[77]
- Additionally, this grant may qualify for the recommended Grant Matching program. The same startup may also be eligible for training and loans through the Ethiopia Women Entrepreneurship Development Project[78] and a candidate for support from the recommended Tax Refund and Tech Credits.
- The startup may also be in a position to take advantage of the expertise of a senior public servant via the Startup Act's Startup Leave policy.
- The Ecosystem Unit staff would be able to help the business's founder(s) prioritise requests and assist in overcoming any bottlenecks in the application processes.

[77] "Fund-of-Funds Investing in Clean Energy Infrastructure in Developing Countries," United Nations Climate Change, accessed October 1, 2021, https://unfccc.int/climate-action/momentum-for-change/activity-database/momentum-for-change-fund-of-funds-investing-in-clean-energy-infrastructure-in-developing-countries.

[78] "Women Entrepreneurship Development Project (WEDP)," Women Entrepreneurship Development Project WEDP, accessed October 1, 2021, http://wedpet.org/index.html.

6.3.2 Coordination of Support Programs — Impact Seen With 6 – 18 months, Ongoing Program

The Ecosystem Unit will offer a non-partisan forum for coordinating investor activities, international development support and national and local government programs. It will also aid the providers of both public and private sector support by gathering and analysing feedback from its constituents to help them improve their impact.

6.3.3 Policy & Regulatory Advocacy and Dissemination— Impact Seen Within 1-2 Years, Ongoing Program

The Ecosystem Unit will foster a mutually beneficial business environment through proactive policy advocacy at the state and federal level. A major responsibility of the centre will be to keep current on and raise awareness of the challenges facing startups and to make associated requests for updates to the Startup Proclamation Act. It will also be the responsibility of the unit to collaborate with MInT and other relevant ministries and regulators to ensure that the startup community is kept informed of new policies as they are developed and enacted. This will help to reduce the disconnect between the reality—that the Government is taking decisive steps to create a more nurturing environment for startups—and the more negative perceptions of the private sector, which were noted in the stakeholder interviews.

An Ethiopian example could proceed as follows:

- To address the difficulties early-to-mid stage startups face in arranging debt financing through official channels (as outlined above), the Ecosystem Unit will engage with banks, savings and credit co-operative organisations, and microfinance institutions to understand what these financial institutions consider impediments to lending to startups.
- The fact that the "Jumpstart Ethiopia" SAOE is at arms-length to the Government should make these interactions more candid and therefore more valuable. The team at the Ecosystem Unit would then develop recommendations aimed at addressing the gaps between the requirements of formal lending organisations and resources available to most startups.
- If it is in the mandate of the SAOE to implement the necessary changes to the Credit Loss Guarantee program, it would then do so.
- For more substantial changes, the unit would present the recommendations to MInT, which would reconcile them to the Government's priorities and take the lead in the policy adjustment process.
- The Ecosystem Unit would keep the startup market apprised of progress and help to prepare the market participants for the changes (through communications, training etc.).

6.3.4 Knowledge Bank— Quick Win (Impact Seen Within 3-6 Months), Ongoing Program

The Entrepreneur Knowledge Bank will provide essential information for entrepreneurs about regulations and policies in the country. Considering that the knowledge about best-practice development is deemed a global public good, the role of this unit will be the development of a robust information think-tank that will benefit all potential entrepreneurs.

The virtual library covers everything from how to set up a company, to the regulatory requirements for running a business in a particular sector, to information about the full spectrum of applicable taxes. The knowledge bank can act as a one-stop-shop for all startup-related information, whether it relates to fintech, edtech, agritech or tourismtech.

6.3.5 Startup Events & Hackathons— Impact Seen Within 6 - 18 Months, Ongoing Program

The Ecosystem Unit will leverage the resources of the Innovation Challenge Fund to finance creative competitions such as hackathons and “pitch-off” events. These events, which typically last from one to three days, unite teams of innovative people who may not otherwise have a chance to connect in a high-intensity push to solve problems with technology. Specialised events should be run to encourage neglected segments such as rural persons, women, children, and youth under 14 (divided into sub-categories). Grouping participants by level of education, perhaps through events limited to those who have not had the benefit of post-secondary education, is another way to uncover persons with great ideas who are often shut out of the technology startup ecosystem.

These challenges and competitions have come to be considered the best way to target support for subsectors of digital startups across the globe, as they do not introduce long-term market distortions but instead generate the motivation for creative people to focus on a specific need —such as extending financial services to the poor; solving a specific health monitoring problem through the use of a smart phone; or building tools that allow tourists and travel professionals to build itineraries based on low-carbon choices. The rewards for outstanding performances in these events should be substantial and include development grants, no-interest loans, and/or membership in an incubation or acceleration program. The goal is to incentivise participation in target sectors, be it agritech, healthtech, edtech etc., surface and nurture exceptional ideas, and build an active community of high-quality startups that will be attractive to investors and supercharge the economic sector. With this in mind, all participants that score above predetermined thresholds should be eligible to share in reward packages. Successful ideas should be widely publicised.

The Ecosystem Unit will work in close collaboration with the Marketing Unit to publicise events to drive engagement from target participant groups, potential investors, and the general public. The ideas and startups that score well should be celebrated via:

- domestic marketing campaigns to encourage more innovative risk-taking and idea generation, and
- regional and international marketing campaigns to attract the interest of investors and pan-national incubation and acceleration programs.

6.3.6 Empowerment of Incubators and Accelerators— Quick Win (Impact Seen Within 6-12 Months), Ongoing Program

Nurturing and empowering incubators and accelerators would appreciably address widespread concerns about the lack of access to workspaces and mentorship voiced in the stakeholder interviews. Going beyond the tax breaks and funding of incubation fees offered in the Startup Act, the Ecosystem Unit will support domestic, regional, and international incubators and accelerators operating in Ethiopia using financing from the Incubation Fund. The monies should be directed to allow these ecosystem builders to:

- open extensions or sibling organisations outside of Addis Ababa,
- increase their existing ability to offer co-working spaces,
- partner with colleges and universities or the private sector through a public-private partnership model to provide a network of affordable workspaces,
- engage credible mentors and instructors to offer specialised content for sector-specific cohorts (e.g., agritech, fintech, edtech, healthtech, etc.),
- translate and disseminate the wealth of knowledge available across the globe at low (or no) cost for successful organisations such as Y-Combinator,
- plan and conduct (or sponsor) sector-specific events at regular intervals, at which subject matter experts can provide guidance and advice to both registered startups and the interested public, and
- convene live or real-time virtual events outside of Addis Ababa to engage a wider audience of potential entrepreneurs.

6.4 Marketing Unit

Headed by the Marketing Director, this unit's main mandate will be to promote the Ethiopian startup ecosystem at the international level and to generate funding for the "Jumpstart Ethiopia" (SAOE) with the objective of making it self-reliant. The unit will be mainly focused on the following initiatives:

6.4.1 Donor Interactions—Impact Seen in 6-18 Months, Ongoing Program

For the SAOE to become self-reliant, it will be imperative for the leadership team to interact with donors and international development agencies. Their purpose will be to present a collaborative and transparent environment, whether at events that promote the ecosystem, when directly raising investments for VC FoF and investee funds or when applying for funding. It is important for the various investment vehicles of the "Jumpstart Ethiopia" SAOE to be positioned to benefit from the global interest in public-private cooperation ("blended financing") to support important development goals such as the Sustainable Development Goals (SDGs).

6.4.2 Ecosystem Promotional Activities—Impact Seen in 6-18 Months, Ongoing Program

The Marketing Unit will actively promote the startup ecosystem and outstanding Ethiopian businesses to foreign investors via invitational events in Ethiopia, along with interactive visits with local stakeholders. These choreographed visits should be organised with an eye to promoting the comfort and consideration of international investors, leaving them with a favourable impression of Ethiopia's companies and productivity prospects.

6.4.2.1 International precedents: In-Country International Marketing Events

Pakistan's 021Disrupt event was launched in 2017 and is now considered the steppingstone that helped bring Pakistan's startup ecosystem to the attention of the world. Since the launch, FDI in Pakistani startups has grown severalfold.[79]	**Pakistan**
Northern Europe	Arctic15 may be the most effective matchmaking startup event in Northern Europe, with a strong focus on deal-making and quality networking. The two-day event brings together a focused international crowd of startups, investors, corporates, media, and influencers.[80]

As noted in Section 0, the Marketing Unit will work closely with the Ecosystem Unit to publicise events such as hackathons and innovation challenges with the aim of driving engagement from target participant groups, potential investors, and the general public. The ideas and startups that score well should be celebrated through:

- domestic marketing campaigns to encourage innovative risk-taking and idea generation, and
- regional and international marketing campaigns to attract the interest of investors and pan-national incubation and acceleration programs.

[79] "021DISRUPT 2020 - Pakistan's Premier Technology and Entrepreneurship Conference," Clarity PK, November 26, 2020, https://clarity.pk/news/021disrupt-2020-pakistans-premier-technology-entrepreneurship-conference/.

[80] James McCann, "Nordic Early Stage Investment Recovering Based on Bullish Mood at Arctic15," Nordic Startup News, October 23, 2020, https://nordicstartupnews.com/nordic-early-stage-investment-recovering-based-on-bullish-mood-at-arctic15/.

7 Case Study Tunisia: A World Bank-endorsed Model for Ethiopia's Semi-Autonomous Startup Ecosystem Framework

7.1 Original State (2017)

In 2017, six years after the Jasmine Revolution, the Government of Tunisia (GoT) was looking for a new economic approach. GDP growth had slowed to 1.7% per annum between 2011-2017 from 4.5% in the period spanning 2005-2010. The economy remained dominated by the public sector and the private sector was, according to the World Bank, "stuck in low-value added activities" such as non-luxury agriculture and low-value textiles. Inflation hovered around 7%, driven in part by the depiction of the currency and increases in public sector wages. Unemployment was high at 15.5% and, most concerning, very high (31%) among the remarkably large cohort of young graduates from the country's well-regarded high education system.

7.2 Challenges Familiar to Ethiopia

Compounding these issues, Tunisia was a difficult environment for MSMEs, especially in innovative areas. Many of the challenges are familiar to entrepreneurs in Ethiopia. Legal and regulatory issues included a slow and complicated business registration process, unclear rules for e-commerce, and no distinct legal definition of a "startup".

Access to capital was a key roadblock. The lack of accurate credit reporting hampered financial institutions lending to small businesses and those enterprises based on intellectual capital faced the familiar difficulty of proving their value in the absence of much, or any, physical collateral. International venture capital was constrained by a protectionist foreign exchange policy and the established domestic business class was, according to interviews reported by the World Bank, not interested in new ideas. Even though there was significant funding available from various government agencies and a plethora of foundations, development agencies and NGOs, these programs were not coordinated with each other and were often not efficiently deployed or publicised.[81]

[81] "The Tunisian Startup Act," INSME, accessed October 3, 2021, https://www.insme.org/the-tunisian-startup-act/.
"Tunisia Financing Innovative Start-Ups and SMEs (Project 167380)," Documents & Reports (The World Bank, 2018), https://documents1.worldbank.org/curated/en/133791541834427775/pdf/Concept-Project-Information-Document-PID-Tunisia-Innovative-Startups-and-SMEs-Project-P167380.pdf.

7.3 Enabling Actions

Faced with these challenges, the GoT embarked on a program of policy changes aimed at enabling new businesses. The **2016 Investment Law** took steps to create a more friendly environment for foreign investors by:

- legislating quality between foreign and domestic investors.
- granting foreigners, the right to acquire, lease, or operate non-agricultural immovable property.
- allowing a new business to employ a minimum of 4 foreign executives or 30% of the total number of its managers, with a reduction to 10% as of the fourth year.
- permitting the free transfer of the profit, dividends, and capital abroad in foreign currency, in accordance with the applicable foreign exchange legislation.
- creating investment subsidies for direct investment which increases competitiveness, the employability of the workforce, regional growth, and sustainable development.
- establishing that foreign investors have the same rights and obligations provided for by the Investment Law as Tunisian investors in comparable situations.[82]

The Investment Law was closely followed by the **2017 Tax Incentives Law** which provides incentives relating to export operations, agriculture, depollution activities, investments in regional development zones and new companies. The deduction on taxable profit/revenue for new businesses is now set at 100% for the first year decreasing by 25% per year to 25% for the 4th year.[83]

[82] "Tunisia - Corporate Tax Credits and Incentives," PwC - Worldwide Tax Summaries Online, July 2021, https://taxsummaries.pwc.com/tunisia/corporate/tax-credits-and-incentives and 2016 Investment Law (No 2016-71 and https://taxsummaries.pwc.com/tunisia/corporate/tax-credits-and-incentives.

[83] 2017 Tax Incentives Law no 2017-8 February 2017 and https://taxsummaries.pwc.com/tunisia/corporate/tax-credits-and-incentives.

7.4 Framework to Empower a Startup Ecosystem

In 2018, following a 2-year collaborative public-private process by a task force reporting[84] to the Minister of Technology, the Tunisian parliament approved the **Startup Act.**

The Startup Act creates:

- a label of merit-based qualification system which is open to both domestic startups and foreign subsidiaries with:
  - objective (size, age, ownership) & subjective (innovative character, growth potential) criteria,
  - a review board of public and private sector volunteers, and
  - a digital applications portal.
- an independent operating company, Smart Capital, a public-private operations unit which:
  - is privately managed, with public and private shareholding,
  - is governed by a Board of Directors consisting of public-private representatives,
  - hires for, oversees, and reports on a funding unit (Startup Invest) and an ecosystem unit (Startup Empower/Flywheel), and
  - has as key staff consisting of a managing director, an operations director, an investment director, an ecosystem director, and a marketing director.

Smart Capital, through its investing arm, Startup Invest, oversees and operates the Anava Fund (FoF) and the InnovaTech Fund (co-investment). It chooses the fund managers and directs the overall investment strategy and also oversees all reporting and compliance.[85]

Through Flywheel/Startup Empower, Smart Capital is responsible for ecosystem and firm-level support activities, for coordinating with other similar programs in Tunisia and for making recommendations to the Government on all matters affecting the startup ecosystem.[86]

The creation of a semi-autonomous operating company was endorsed by the World Bank which, together with GIZ, has provided much of the setup capital.

---

[84] "Startup Act Annual Report, 2019 - 2020," p. 13, Startup Tunisie, December 2020, https://www.startupact.tn/rapport/Startup-Act-Annual-Report-2019-2020-en.pdf.

[85] # 26 of report "The program will be managed by a private sector fund management company, Smart Capital, to be established by the Government" https://documents1.worldbank.org/curated/pt/853221560823315952/pdf/Tunisia-Innovative-Startups-and-Small-and-Medium-Enterprises-Project.pdf.

[86] "Project Appraisal Document for an Innovative Startups and Small And Medium Enterprises Project," Documents & Reports (The World Bank, 2019, pp.21-26), https://documents1.worldbank.org/curated/pt/853221560823315952/pdf/Tunisia-Innovative-Startups-and-Small-and-Medium-Enterprises-Project.pdf.

7.5 Funding Arrangements and Initial Setup

In June 2019, the World Bank approved a concessionary loan of $75M USD to support the Startup Tunisia program and its operator, Smart Capital, to be paid based on milestones achieved and applied as follows:

Project Activity	World Bank Loan (USD, millions)
1. Equity and Quasi-Equity Financing for Innovative Startups and SMEs	**62**
Anava Fund of Funds for Innovative Startups	45
InnovaTech Fund for Innovative SMEs	17
2. Ecosystem and Firm-Level Support for Innovative Startups and SMEs	**8**
Startup Ecosystem and Deal Flow Support	5
SME Investment Readiness and Technology Adoption Support	3
3. Project Management and Capacity Building	**5**
Total	**75**

Table 7 Financing for Innovative Startups and SME Tunisia (World Bank) [87]

As of May 2021, Smart Capital, the Anava Fund of Funds, the Flywheel ecosystem unit, and other institutional elements have been set up, a first call issued for grant applications to ecosystem support organisations (incubators, accelerators, mentorship networks) and startups, and 31% of the loan had been disbursed.

[87] "Project Appraisal Document on a Proposed Loan to the Republic of Tunisia for an Innovative Startups and Small And Medium Enterprises Project," Documents & Reports (The World Bank, 2019, p.20), https://documents.worldbank.org/curated/pt/853221560823315952/pdf/Tunisia-Innovative-Startups-and-Small-and-Medium-Enterprises-Project.pdf.

	Smart Capital				Total
	Anava Fund of Funds (Indirect Investment)			InnovaTech Fund (Direct Co-Investment)	
Investment stage	**Seed Stage** (US$50,000–US$300,000)	**Early Stage** (US$300,000–US$500,000)	**Growth Stage** (US$500,000–US$1,000,000)	**Growth Stage** (US$300,000–US$1,000,000)	
Allocation	**US$20 million**	**US$22 million**	**US$3 million**	**US$17 million**	**US$62 million**
FIs	Accelerators, angel networks, and seed stage funds	Accelerators stage and VC funds	VC funds	Co-investment with VC funds and other private investors	
Sectors	Opportunistic with focus on digital media, education technology, health technology, financial technology, green technology and renewable energy, agribusiness, manufacturing, ICT and electronics, big data and analytics, and marketplaces and e-commerce				
Target number of funds	Up to 3 funds	Up to 2 funds	1 fund	1 fund	Up to 7 funds
Target fund size	Up to US$10 million	Up to US$22 million	Above US$20 million	US$34 million	

	Smart Capital				Total
	Anava Fund of Funds (Indirect Investment)			InnovaTech Fund (Direct Co-Investment)	
Allocation per fund	Up to US$7.5 million	Up to US$11 million	US$3 million	US$17 million	
Private leverage (%)	25	50	85	50	
Private leverage	Average US$2.3 million per fund (US$7 million total)	US$11 million per fund (US$22 million total)	US$17 million	US$17 million	**US$63 million**
Number of companies	90–100 companies	90–100 companies	20–25 companies	40–50 companies	About 280 companies
Total funds	**US$27[a] million**	**US$44 million**	**US$20 million**	**US$34 million**	**US$125 million**

Table 8 Smart Capital Tunisia, Capitalisation Details (Startup Tunisie) [88]

The second call for applications ran from August 30 to September 10, 2021. Currently, the target date for the first investments into the child funds of the Anava FoF and to innovative startups and SMEs is set for December 2021. This may not be achievable given the public unrest in Tunisia during August and September 2021, but if Smart Capital continues to progress towards its goals through this uncertainty, it will underscore the benefits of the independent operator model.

[88] "Startup Act Annual Report, 2019 - 2020," Startup Tunisie, December 2020, https://www.startupact.tn/rapport/Startup-Act-Annual-Report-2019-2020-en.pdf.

7.6 Indications of Tunisia's Success

While Smart Capital has yet to complete its setup, the Investment and Tax Incentives Laws and the Startup Act seem to have already improved the startup ecosystem in Tunisia. Since late 2018, 450 enterprises, from a pool of 750 candidates, have been labeled as startups and have qualified for financial and technical support.[89] Between 2017 and 2021, Investment in Tunisian startups increased 31%, and 2020-21 saw a total investment of US$38.2M USD across 54 deals.[90]

7.7 A Model for Ethiopia

Fostering Public-Private Collaboration: The Tunisian experience is a strong example of collaboration between the public and private sectors, with the startup community playing an active role in developing legislation, regulation and operational structures and processes. Ethiopia should regard features of the Tunisian processes as a model for elevating legislative processes, ensuring applicability to the startup market and increasing stakeholder participation.[91]

Creating a Separation between Policy Creators and Policy Implementors: Empowering a semi-autonomous operating entity, similar to Smart Capital, for the implementation and administration of the Startup Act, will aid in eliminating current inefficiencies caused by the difficulties of coordination among government ministries, commissions, and agencies. This approach would create a clear distinction between the governmental duties of MInT and the investment and disbursement decisions surrounding both the VC FoF and the secondary investment vehicle. This separation would allow each organisation to excel at its primary tasks and to avoid becoming mired in any problems for which they were not responsible. The Tunisian experience demonstrates that development agencies, which will be critical sources of finance and technical assistance for the SAOE "Jumpstart Ethiopia", favour this model.

Understanding Implementation Timelines: MInT and MoF are in a position to avoid some of the timeline challenges faced by Smart Capital. Tunisia was able to move very swiftly after the adoption of the Startup Act to implement the process of granting the "startup" label to the appropriate applicants, but it has taken more than a year to set up the institutional elements and to issue the first call for grant applications. Ethiopia would be wise to avoid the confusion, disappointment, and investor hesitancy resulting from a long gap between startups being granted eligibility for targeted support and actually having access to the programs. This could be achieved by delaying the start of the label

[89] "Tunisia Launches a $75m Fund for Startups," Afrikan Heroes, March 24, 2021, https://afrikanheroes.com/2021/03/24/tunisia-launches-a-75m-fund-for-startups.

[90] "Ecosystems - Tunisia," Startup Genome, accessed October 4, 2021, https://startupgenome.com/ecosystems/tunisia.

[91] "The Tunisian Startup Act," INSME, accessed October 3, 2021, https://www.insme.org/the-tunisian-startup-act.

application process until the ecosystem support institutions and financing are nearly operational.

The Ethiopian Government should be aware that establishing ecosystem support functions (e.g., funding for ecosystem enablers and the issuing of calls for applications for sponsorship from startups) will take considerably less time than the setup of the VC FoF. If the Government is able to pay for the support measures with funds on hand, such as those from the Khalifa Fund for Enterprise Development, early-stage startups could realistically be receiving support within 6 months of the adoption of the Startup Act.

8 Conclusion

Ethiopia's pragmatic and aggressive approach to expanding its telecommunications infrastructure has turned out to be prescient. The increased reliability of the electrical system, additional fibre links, and measures to increase affordability of access and devices have together helped drive connectivity and accessibility for all Ethiopians. That network can now form the basis of a powerful and innovative startup ecosystem, one with the potential to stimulate economic growth and employment across the country.

As in many other nations, the availability of experienced investment professionals capable of leveraging FDI to grow ideas into IPOs is one of the key constraints on the development of a technology-enabled startup ecosystem. This issue can be readily resolved through knowledge transfer during the transition to a technology-friendly economy. It is a straightforward task for foreign professionals with experience in international investment markets to provide instruction and education to the next generation of investment talent in the country. The critical task is fostering an environment that attracts such professionals.

Other countries have found that setting up a fund of funds model to stimulate entrepreneurship has not only attracted such finance veterans, but it has also stimulated job creation, productivity growth, and skills acquisition in the domestic workforce. Viewed holistically, the purpose of FoFs is not to demand high isolated returns, but to stimulate multiple foreign investment funds to develop companies capable of producing, selling, and exporting innovative and competitive products and services. Although it may take some time before such companies grow large enough to have a marked effect on trade balances, a sustained increase in venture capital availability and startup-friendly policies will ultimately transform technology from an isolated and esoteric sector into an enabling and embedded function across all industries—both the emerging and the established.

Turning brilliant entrepreneurial ideas into enterprises that will prosper and deliver returns over the long run requires business leaders trained in the models, marketing, and strategies necessary to compete in international markets. Developing such executives will require knowledge transfer from foreign fund managers who can identify the domestic startups most likely to evolve into full-blown success stories with the right attention and resources. Again, FoFs are of benefit here since such strategies have proven success at attracting foreign professionals and FDI together. Once in-country, such knowledge and capital have a high tendency to persist and remain active in the economy for decades, and to springboard domestic firms onto global markets. When wielded alongside small but impactful adjustments in policy, these can result in the kind of vibrant and sustainable private capital market which predicates the full and sustainable digitisation of a national economy.

Although a lack of harmonisation of nationwide policies—across taxation and regulation—remains a limiting factor, the foremost barrier to Ethiopia's goal of creating a vibrant startup ecosystem relates to capital access. This Note includes a range of Recommendations designed to drastically improve the financial foundations of entrepreneurial companies and to make it easier for them to do business. The entire effort hinges upon the Government adopting a comprehensive framework designed to empower a healthy and sustainable digital startup ecosystem, underpinned by a fund of funds designed to increase investment flows into early-stage Ethiopian private sector enterprises.

This Framework would mirror successful initiatives rolled out elsewhere in the world and would focus on key areas:

1. **Investment Management:** To form and manage Incubation funds and grants, including creating and managing a general VC fund of funds and a co-Investment fund for exceptional or ground-breaking ideas.
2. **Ecosystem Development**: To provide startups with basic resources, convene events, encourage knowledge-sharing, and equip and manage common and accessible spaces.
3. **Marketing**: To promote the sector with foreign and domestic investors, to build public awareness, and to interface with donors and stakeholders.

The current policy direction of the Government is on track to address the harmonisation question, along with a few logistical challenges faced by digital startups in Ethiopia. The Recommendations in this Note will augment and accelerate this effort, ease the path to business creation for startup founders, ensure a strong voice in government advocating for startup enterprises, and guarantee that fledgling enterprises can access enough capital to bring their ideas to life.

9 Bibliography & Appendices

9.1 Bibliography

"Ethiopia Startup Ecosystem - Middle East & Africa." StartupBlink Blog, May 26, 2021. https://www.startupblink.com/blog/ethiopia-startup-ecosystem.

"021DISRUPT 2020 - Pakistan's Premier Technology and Entrepreneurship Conference." Clarity PK, November 26, 2020. https://clarity.pk/news/021disrupt-2020-pakistans-premier-technology-entrepreneurship-conference.

"2020 - GSMA Mobile Connectivity Index." GSMA, 2020. https://www.mobileconnectivityindex.com.

"Application and Selection Process." blueMoon. Accessed December 23, 2021. https://www.bluemoonethiopia.com/bluemoon-incubator/application-and-selection-process.

"Arifpay Emerges Winner of Visa Everywhere Initiative 2021 in Ethiopia." Visa, July 2021. https://africa.visa.com/visa-everywhere/blog/bdp/2021/07/15/arifpay-emerges-winner-1626326589255.html.

Asfaw, Belachew. "Ethiopian National Innovation Survey-2019." ResearchGate. FDRE Technology and Innovation Institute, 2021. https://www.researchgate.net/publication/349809596_Ethiopian_National_Innovation_survey-2019.

Avnimelech, Gil, Martin Kenney, and Morris Teubal. "Building Venture Capital Industries: Understanding the U.S. and Israeli Experiences." SSRN, April 4, 2016. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2758198.

Bakker, Eline. "Strengthen WASH Business in Ethiopia: Access to Foreign Exchange." IRC, December 2020. https://www.ircwash.org/news/strengthen-wash-business-ethiopia-access-foreign-exchange.

"Banking Business Proclamation 1159-2019." National Bank of Ethiopia, 2019. https://nbebank.com/wp-content/uploads/pdf/directives/bankingbusiness/banking-business-proclamation-1159-2019.pdf.

Broussard, Nzinga, and John Page. "Ethiopia." Essay. In Youth and Employment in Sub-Saharan Africa: Working But Poor, edited by H Hino and G Ranis, 2014. https://doi.org/10.4324/9780203798935.

"Case Study: Universal Credit Scoring for Female-Led SMEs in Ethiopia." LenddoEFL, May 18, 2021. https://lenddoefl.com/news/2021/5/17/case-study-universal-credit-scoring-for-female-led-smes-in-ethiopia.

Conceição, Pedro. "Human Development Report 2020 - United Nations Development ..." Human Development Reports. United Nations Development Programme, 2020. http://hdr.undp.org/sites/default/files/hdr2020.pdf.

"Corruption Perceptions Index 2020: Ethiopia." Transparency.org. Transparency International, 2020. https://www.transparency.org/en/cpi/2020/index/eth.

"Country Rankings." Country Rankings: World & Global Economy Rankings on Economic Freedom. The Wall Street Journal, 2021. https://www.heritage.org/index/ranking.

Croce, Annalisa, Jose Martí, and Carmelo Reverte. "The Role of Private versus Governmental Venture Capital in Fostering Job Creation during the Crisis." Small Business Economics 53, no. 4 (2018): 879–900. https://doi.org/10.1007/s11187-018-0108-3.

Demombynes, Gabriel, and Aaron Thegeya. "Kenya's Mobile Revolution and the Promise of Mobile Savings." World Bank eLibrary. World Bank Group, March 2012. https://doi.org/10.1596/1813-9450-5988.

Denning, Stephanie. "Why Amazon Pays No Corporate Taxes." Forbes. Forbes Magazine, February 25, 2019. https://www.forbes.com/sites/stephaniedenning/2019/02/22/why-amazon-pays-no-corporate-taxes/?sh=2f0af42f54d5.

Divakaran, Shanthi, Sam Schneider, and Patrick McGinnis. "Ghana Private Equity and Venture Capital Ecosystem Study." Documents & Reports. World Bank, October 2018. https://documents.worldbank.org/curated/en/244861539865691381/pdf/WPS8617.pdf.

"Doing Business 2020." documents1.worldbank.org. The World Bank, 2020. https://documents1.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf.

"Economic Impact of the COVID-19 Pandemic on East African Economies, Volume 2." Deloitte. Deloitte, 2021. https://www2.deloitte.com/content/dam/Deloitte/ke/Documents/finance/Economic%20Impact%20of%20the%20Covid-19%20Pandemic%20on%20East%20African%20Economies-Volume%202.pdf.

"Ecosystems - Tunisia." Startup Genome. Accessed October 4, 2021. https://startupgenome.com/ecosystems/tunisia.

Eliasz, Toni, Jamil Wyne, and Sarah Lenoble. "The Evolution and State of Singapore's Start-up Ecosystem." Open Knowledge Repository. World Bank, March 1, 2021. https://openknowledge.worldbank.org/handle/10986/35328.

Endeshaw, Dawit. "Exclusive: Ethiopia to Reopen Bidding for Second Telecoms Licence, Officials Say." Reuters. Thomson Reuters, August 2, 2021. https://www.reuters.com/business/media-telecom/exclusive-ethiopia-reopen-bidding-second-telecoms-licence-officials-say-2021-08-02.

Engberg, Erik, Patrik Gustavsson Tingvall, and Daniel Halvarsson. "Direct and Indirect Effects of Private- and Government-Sponsored Venture Capital." Empirical Economics 60, no. 2 (2019): 701–35. https://doi.org/10.1007/s00181-019-01770-w.

"Ethiopia - Country Commercial Guide - Market Challenges." International Trade Administration. US Government, 2021. https://www.trade.gov/country-commercial-guides/ethiopia-market-challenges.

"Ethiopia - Investment Proclamation No1180/2020." Investment Policy Hub. United Nations Conference on Trade and Development, April 2, 2020. https://investmentpolicy.unctad.org/investment-laws/laws/318/ethiopia-investment-proclamation-no1180-2020.

"Ethiopia - Telecoms, Mobile and Broadband - Statistics and Analyses." GlobeNewswire News Room. BuddeComm, November 16, 2020. https://www.globenewswire.com/en/news-release/2020/11/16/2127638/0/en/Ethiopia-Telecoms-Mobile-and-Broadband-Statistics-and-Analyses.html.

"Ethiopia - The World Factbook." Central Intelligence Agency. Central Intelligence Agency, November 16, 2021. https://www.cia.gov/the-world-factbook/countries/ethiopia/#people-and-society.

"Ethiopia's Transformational Approach to Universal Electrification." World Bank. World Bank, March 8, 2018. https://www.worldbank.org/en/news/feature/2018/03/08/ethiopias-transformational-approach-to-universal-electrification.

"Ethiopia's Digital Economy." Cepheus Growth Capital Partners. Accessed October 3, 2021. https://cepheuscapital.com/wp-content/uploads/2019/01/Ethiopias-Digital-Economy.pdf.

FDRE-MiNT. "A Digital Strategy for Ethiopia Inclusive Prosperity." mint.gov.et. MiNT, May 2020. https://mint.gov.et/wp-content/uploads/2021/05/Digital-Ethiopia-2025-Strategy-english.-.pdf.

"Finance (No. 2) Act 2017." Legislation.gov.uk. Queen's Printer of Acts of Parliament, November 16, 2017. https://www.legislation.gov.uk/ukpga/2017/32/contents/enacted/data.htm.

"First Ever Founder Institute Ethiopia Startup Accelerator Opens Applications. Let's Build the Future." The Founder Institute, June 2020. https://fi.co/insight/first-ever-founder-institute-ethiopia-startup-accelerator-opens-applications-let-s-build-the-future.

Fisher, Peter. "State Venture Capital Funds as an Economic Development Strategy." Journal of the American Planning Association 54, no. 2 (1988): 166–77. https://doi.org/10.1080/01944368808976471.

"Fund-of-Funds Investing in Clean Energy Infrastructure in Developing Countries." United Nations Climate Change. Accessed October 1, 2021. https://unfccc.int/climate-action/momentum-for-change/activity-database/momentum-for-change-fund-of-funds-investing-in-clean-energy-infrastructure-in-developing-countries.

"G7 Development Finance Institutions and Multilateral Partners to Invest over $80 Billion into African Businesses over the next Five YearsJ." African Private Equity and Venture Capital Association, June 2021. https://www.avca-africa.org/newsroom/member-news/2021/g7-development-finance-institutions-and-multilateral-partners-to-invest-over-80-billion-into-african-businesses-over-the-next-five-years.

Girma, Kaleab. "Despite Lack of Outstanding Hatches, Startup Incubators Continue to Launch in Ethiopia." AfroLeap, August 7, 2021. https://afroleap.com/despite-lack-of-outstanding-hatches-startup-incubators-continue-to-launch-in-ethiopia.

"Global Competitiveness Index, 2019: Ethiopia." Reports. World Economic Forum, 2019. http://reports.weforum.org/pdf/gci4-2019/WEF_GCI4_2019_Profile_ETH.pdf.

"Global Startup Ecosystem Index 2021." StartupBlink, 2021. https://www.startupblink.com/startupecosystemreport.pdf?mc_cid=9dc40ae5f2&mc_eid=6f5381bffe.

Green, M B. "Patterns of Preference for Venture Capital Investment in the United States of America, 1970–85." Environment and Planning C: Government and Policy 7, no. 2 (1989): 205–22. https://doi.org/10.1068/c070205.

Haag, Matthew. "Amazon's Tax Breaks and Incentives Were Big. Hudson Yards' Are Bigger." The New York Times. The New York Times, March 9, 2019. https://www.nytimes.com/2019/03/09/nyregion/hudson-yards-new-york-tax-breaks.html.

Hinrichsen, Simone. "Exploring the Rising Tunisian Start-up Ecosystem." Mobile for Development. GSMA, November 16, 2020. https://www.gsma.com/mobilefordevelopment/blog/exploring-the-rising-tunisian-start-up-ecosystem.

"A Homegrown Economic Reform Agenda:
A Pathway to Prosperity." FDRE Ministry of Finance, September 2019. https://www.mofed.gov.et/media/filer_public/38/78/3878265a-1565-4be4-8ac9-dee9ea1f4f1a/a_homegrown_economic_reform_agenda-_a_pathway_to_prosperity_-_public_version_-_march_2020-.pdf.

"A Homegrown Reform Agenda: Unlocking Ethiopia's Economic Potential." FDRE Ministry of Finance, August 2019. https://www.mofed.gov.et/media/filer_public/0e/4c/0e4c0c11-8262-4e53-b395-0b1c0aa26976/ethiopia-_economic_reform_agenda_.pdf.

"How Venture Capitalists Make Decisions." Harvard Business Review, September 17, 2021. https://hbr.org/2021/03/how-venture-capitalists-make-decisions.

IFC. "Creating Markets in Ethiopia: Country Private Sector Diagnostic." ifc.org. IFC, 2019. https://www.ifc.org/wps/wcm/connect/publications_ext_content/ifc_external_publication_site/publications_listing_page/cpsd-ethiopia.

"IFC's Priorities in Funds." ifc.org. Accessed October 4, 2021. https://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/funds/priorities/priorities.

"IMF Real GDP Growth - Ethiopia." International Monetary Fund. Accessed October 4, 2021. https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/ETH?zoom=ETH&highlight=ETH.

"India's Surge in VC Minting Unicorns at Record Pace." PitchBook, September 20, 2021. https://pitchbook.com/news/articles/2021-india-vc-unicorns-record-pace.

"Insurance Business Proclamation 1163-2019." National Bank of Ethiopia, January 9, 2020. https://nbebank.com/wp-content/uploads/pdf/directives/insurancebusiness/insurance-business-proclamation-1163-2019.pdf.

"Investment Regulation No. 474/2020." Ethiopian Chamber of Commerce, September 2020. http://ethiopianchamber.com/Data/Sites/1/2013%20EC/Attachement/Investment_Regulation_No_474_2020.pdf.

Kelly, Lauren, and José Carbajo Martinez. "Can Ethiopia Create 2 Million Jobs Every Year?" Independent Evaluation Group. World Bank Group, September 4, 2018. https://ieg.worldbankgroup.org/blog/can-ethiopia-create-2-million-jobs-every-year.

Kovács, Tamás, and Julianna Vajay. "Effects of State-Owned and Hybrid Venture Capital Funds in Hungary." Procedia Economics and Finance 30 (2015): 430–35. https://doi.org/10.1016/s2212-5671(15)01310-6.

"Maqsad Scores Largest Funding among Pakistan Edtech Startups." BNN Bloomberg, September 20, 2021. https://www.bnnbloomberg.ca/maqsad-scores-largest-funding-among-pakistan-edtech-startups-1.1654532.

McCann, James. "Nordic Early Stage Investment Recovering Based on Bullish Mood at Arctic15." Nordic Startup News, October 23, 2020. https://nordicstartupnews.com/nordic-early-stage-investment-recovering-based-on-bullish-mood-at-arctic15.

Morawczynski, Olga. "Exploring the Usage and Impact of 'Transformational' Mobile Financial Services: The Case of M-Pesa in Kenya." Journal of Eastern African Studies 3, no. 3 (2009): 509–25. https://doi.org/10.1080/17531050903273768.

Murray, Gordon C., and David C. Lingelbach. "Twelve Meditations on Venture Capital: Some Heretical Observations on the Dissonance between Theory and Practice When Applied to Public/Private Collaborations on Entrepreneurial Finance Policy." SSRN, November 11, 2009. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1502643.

National Bank of Ethiopia. "National Digital Payments Strategy, 2021–2024." nbe.gov.et. National Bank of Ethiopia, March 2021. https://www.nbe.gov.et/wp-content/uploads/pdf/directives/Payement%20system/National-%20Digital-%20Payment%20Strategy.pdf.

"NBE Issues Directive to License, Authorize Payment Instrument Issuers." National Bank of Ethiopia, April 3, 2020. https://nbebank.com/nbe-issues-directive-to-license-authorize-payment-instrument-issuers-2.

"The New Investment Legislations: Widening the Gateway to Foreign Investment in Ethiopia." Endris Amino Law Office, March 22, 2021. https://ethiopialawoffice.com/the-new-investment-legislations-widening-the-gateway-to-foreign-investment-in-ethiopia.

Ngugi, Brian. "Ethiopia Clears Hurdle for M-Pesa Expansion." Business Daily Africa, August 6, 2021. https://www.businessdailyafrica.com/bd/corporate/companies/ethiopia-clears-hurdle-for-m-pesa-expansion-3500730.

Ntirenganya, Emmanuel. "Pac Grills Finance Ministry Officials over Delayed Projects." The New Times - Rwanda, September 28, 2021. https://www.newtimes.co.rw/news/pac-grills-finance-ministry-officials-over-delayed-projects.

"Overall Rankings." The Inclusive Internet Index. The Economist2021, 2021. https://theinclusiveinternet.eiu.com/explore/countries/performance.

"Oversight of the National Payment System." National Bank of Ethiopia, April 1, 2020. https://www.nbe.gov.et/wp-content/uploads/pdf/proclamation/oversight-the-national-payement-system.pdf.

"Overview of Making Tax Digital." GOV.UK, November 12, 2020. https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital#making-tax-digital-for-income-tax.

"Power Africa in Ethiopia: Power Africa." U.S. Agency for International Development, May 26, 2021. https://www.usaid.gov/powerafrica/ethiopia.

"Proclamation to Provide for Start-up .../2020." ICT ET, 2020. https://ictet.org/wp-content/uploads/2020/08/Laws_ETH_Start-ups-English-2020-06-02.pdf.

"Project Appraisal Document on a Proposed Loan to the Republic of Tunisia for an Innovative Startups and Small And Medium Enterprises Project." Documents & Reports. The World Bank, 2019. https://documents.worldbank.org/curated/pt/853221560823315952/pdf/Tunisia-Innovative-Startups-and-Small-and-Medium-Enterprises-Project.pdf.

"Rwanda Innovation Fund." African Development Bank Group, May 22, 2019. https://www.afdb.org/en/Projects%20%26%20Operations%20%281166%29%2C%20Project%20Appraisal%20Reports%20%281183%29.

"Scale Up! Entrepreneurs' Guide to Investment in Ethiopia." Investment Guide Africa. GBN/GIZ, September 3, 2019. https://investmentguide.africa/sites/default/files/2020-08/GETFIN_Ethiopia.pdf.

Schwab, Klaus, and Saadia Zahidi, eds. "The Global Competitiveness Report, Special Edition 2020: How Countries Are Performing on the Road to Recovery." Reports. World Economic Forum, 2020. https://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2020.pdf.

"Startup Act Annual Report, 2019 - 2020." Startup Tunisie, December 2020. https://www.startupact.tn/rapport/Startup-Act-Annual-Report-2019-2020-en.pdf.

"Startup Recognition & Tax Exemption." Startup India. Accessed October 4, 2021. https://www.startupindia.gov.in/content/sih/en/startupgov/startup-recognition-page.html.

"The State of Tech in AFRICA, 2021." AfricaArena Wired, March 25, 2021. https://f1d0651a-c40a-4877-b5d5-7f6204467ba9.filesusr.com/ugd/cdd60c_5d9debf5822c4e84940b69925d8d2ba2.pdf.

"Tunisia - Corporate Tax Credits and Incentives." PwC - Worldwide Tax Summaries Online, July 2021. https://taxsummaries.pwc.com/tunisia/corporate/tax-credits-and-incentives.

"Tunisia Financing Innovative Start-Ups and SMEs (Project 167380)." Documents & Reports. The World Bank, 2018. https://documents.worldbank.org/curated/en/133791541834427775/pdf/Concept-Project-Information-Document-PID-Tunisia-Innovative-Startups-and-SMEs-Project-P167380.pdf.

"Tunisia Launches a $75m Fund for Startups." Afrikan Heroes, March 24, 2021. https://afrikanheroes.com/2021/03/24/tunisia-launches-a-75m-fund-for-startups.

"The Tunisian Startup Act." INSME. Accessed October 3, 2021. https://www.insme.org/the-tunisian-startup-act.

Van Hove, Leo, and Antoine Dubus. "M-Pesa and Financial Inclusion in Kenya: Of Paying Comes Saving?" Sustainability 11, no. 3 (2019): 568. https://doi.org/10.3390/su11030568.

Wakeford, Jeremy J., Mulu Gebreeyesus, Tsegaye Ginbo, Kassahun Yimer, Ornélie Manzambi, Chukwumerije Okereke, Mairi Black, and Yacob Mulugetta. "Innovation for Green Industrialisation: An Empirical Assessment of Innovation in Ethiopia's Cement, Leather and Textile Sectors." Journal of Cleaner Production. Elsevier, August 9, 2017. https://doi.org/10.1016/j.jclepro.2017.08.067.

Weber, Michael, Amparo Palacios-Lopez, and Ivette Maria Contreras-González. "Labor Market Impacts of Covid-19 in Four African Countries." World Bank Blogs, November 18, 2020. https://blogs.worldbank.org/opendata/labor-market-impacts-covid-19-four-african-countries.

"Women Entrepreneurship Development Project (WEDP)." Women Entrepreneurship Development Project WEDP. Accessed October 1, 2021. http://wedpet.org/index.html.

Wong, Hsin Yee, and Stephen Lam. "How Tax Can Help Anchor Singapore as the Start-up Hub of Choice." EY Singapore, February 15, 2021. https://www.ey.com/en_sg/singapore-budget-2021/how-tax-can-help-anchor-singapore-as-the-start-up-hub-of-choice.

"World Bank SME Finance: Development News, Research, Data." World Bank. Accessed October 3, 2021. https://www.worldbank.org/en/topic/smefinance.

9.1.1 Addendum to Bibliography

From: Kaleab Girma <okkaleab@gmail.com>
Sent: Friday, September 24, 2021 3:55:07 AM
To: Don Harpell <dharpell@digitalfinancial.ca>
Cc: anteneh@shega.org <anteneh@shega.org>

Subject: Re: Ethiopia Statistics for Accelerators / Incubators

Hello Don,

This is Kaleab, a reporter from AfroLeap.

I used the figures using a local news report as a source. But now I really doubt those figures are accurate especially that a new report that sheds light on the Ethiopian ecosystem is out, https://cepheuscapital.com/wp-content/uploads/2019/01/Ethiopias-Digital-Economy.pdf

I think there are now close to close to 20 startup incubators and accelerators in Ethiopia, a figure taken from the report plus including the ones under formation.

Go through the report, am sure you will find a lot of useful information in it. However, if you need more details reach out to Antenhe, founder of Shega, a local digital media, and data analysis startup, cced in this email. Am sure he can help you as he was also involved in the preparation of the report.

Best Rgds,

Kaleab

On Thu, Sep 23, 2021 at 8:52 PM Don Harpell <dharpell@digitalfinancial.ca> wrote:

Good day

I am working in Canada and have been exploring accelerators and incubators in Ethiopia as part of my research. In this article [https://afroleap.com/?p=1670], it states:

"The country has close to 15 startup incubators and 64 accelerators such as iceaddis, blueMoon, and X-hub Addis"

There is no footnote reference for this statistic. Can you direct me to where you obtained your numbers?

Regards

Don Harpell
Consultant at Digital Financial
C: 780.399.0007

9.2 Annex 1

Recommendations on the Policies and Implementation of the Startup Act.

9.2.1 Enhance and Adopt the Definitions of "Startup" and "Innovative Business"

The Startup Act provides very comprehensive definitions of "Startups" and "Innovative Businesses" which align to global standards and clarify the target enterprises for the recommended interventions. The Government is farsighted in creating separate categories for new (under 5 years of legal existence) and more mature enterprises that are driving innovation. The requirement for entrepreneur(s) to maintain a 51% stake in their enterprises to qualify for support under the Act and services provided by the National Startup Council is well-aligned with the goal of encouraging the growth of domestic innovation.

In addition: The Government would be wise to augment the Act with guidance on how compliance with subjective criteria such as "growth potential" and "scalable business model" will be assessed. It is also recommended that incubators and accelerators are subject to a meaningful measurement, such as how many startups are in their programs and how many are successfully launched, if they are to receive special considerations.

9.2.2 Adopt the "Startup Leave" Policy

The Startup Act offers a very attractive route for public sector employees to lend their expertise and energy to the private sector, either as entrepreneur shareholders or full-time employees of startups and innovative businesses. The "Startup Leave" policy guarantees a public employee the opportunity to take an unpaid leave of up to three years from their position while retaining employment privileges (for example employer-provided housing), secure in the knowledge that their role will be held for them. This provides an appealing and low-risk opportunity for knowledge-sharing, skills exchange, and mentoring, and may encourage persons with substantial savings from their public employment to invest both time and money in the startup ecosystem.

This policy is a compelling example of the Government's commitment to leveraging the legacy of the public sector-led economic model to enable digital transformation and a startup economy.

9.2.3 Modify and Adopt the "Startup Scholarship"

The proposed "Startup Scholarship" could be an extremely useful way to address the scarcity of business skills in the Ethiopian market. However, its parameters, as currently outlined, would benefit from greater specificity.

We would recommend that the scholarships cover certification programs as well as diplomas, and that they have the flexibility to support online learning for accredited programs (for example the Certified Digital Finance Practitioner course offered by The Digital Frontiers Institute). We would further recommend that measures be put in put in place to ensure opportunities for women and persons with disabilities.

Suggested modification: The Startup Scholarships should be financed through a single-purpose fund that is separate from both the National Innovation Fund and the recommended VC FoF vehicle. This would make it much more attractive to the many donor organisations and philanthropic individuals who are focused solely on supporting education.

9.2.4 Modify and Adopt the "Retirement and Health Insurance Incentives"

While the Startup Act offers only limited detail on these incentives, the idea that the moneys owed by startups and innovative businesses on behalf of their employees to the national retirement and health schemes would be covered from an external source has considerable merit. Ensuring that the people employed by startups have full coverage under the national social schemes is important for the attraction of talent to the sector. Relieving startups of these costs would also remove a barrier to growth.

Suggested modification: The Retirement and Health Insurance Incentives, like the other specialised programs, should be financed through a single-purpose fund that is separate from both the National Innovation Fund and the recommended VC FoF vehicle. Without this division, the use of the VC fund to pay for government services would imply a potential conflict of interest that could deter international investment in the fund.

9.2.5 Modify and Adopt the Proposed Support for the Registration of Property Rights

The Startup Act intends that "startups and innovative businesses shall be entitled to get support to register their intellectual property nationally".[92] This would be a very valuable service, especially if it included beginning-to-end legal support. The ability of a technology entrepreneur to be certain that they will maintain control of their intellectual capital would greatly increase their confidence when signing agreements to market or enhance their product(s). This same certainty of ownership will make it easier for startups to raise capital, whether through loans or through equity investors.

[92] "Proclamation to Provide for Start-up .../2020," ICT ET, 2020, https://ictet.org/wp-content/uploads/2020/08/Laws_ETH_Start-ups-English-2020-06-02.pdf.

Suggested modification: The current version of the Startup Act states that "startups and innovative businesses may get support to register their intellectual property rights internationally." It is very important that entrepreneurs with a genuinely unique process or product can protect this valuable capital in the world market as well as at home. The Government should unequivocally pledge to support this and consider assisting with international legal costs as well as the promised coverage of registration fees.

9.2.6 Modify and Adopt the Credit Guarantee

The Startup Act generously offers credit guarantees for 100% of the amount borrowed by young businesses. Unfortunately, experience and research have shown that funds borrowed under such high levels of protection are often treated by clients and banks as grants disguised as loans, with both parties often assuming the government will pay. Hence, the clients' incentive to pay off these loans is relatively low, as is the commitment of banks to collect.

Lebanon	To support SME growth, the government of Lebanon has partnered with a loan guarantee agency, Kafalat, to provide lower-interest loans and loan guarantees with no collateral for businesses in a few select sectors. These loans are subsidised by the Lebanese treasury at an interest rate of 6.1% and administered by the Central Bank of Lebanon.

Suggested modification: A 50-70% guarantee might encourage more disciplined borrowing with more risky startup ventures encouraged to tap into actual grant funding or equity funding rather than opting for loans.

9.2.7 Modify and Adopt a Policy for Grants and Subsidised Loans

The Startup Act charges the Innovation Fund to make grants and subsidised loans available through a competitive procedure. This is a welcome policy, with grants being more useful than loans at the earliest stages of business growth. As grants and loans do not require startups to relinquish any equity in their companies, and therefore do not dilute the value of businesses, they lay the groundwork for more successful VC investment as young enterprises mature.

Suggested modification: The Government should refine the policy to address grants to early-stage startups and zero-interest loans to more established startups and innovative businesses.

Suggested modification: The grants and no-interest loans, like the other specialised programs, should be financed through a single-purpose fund that is separate from the National Innovation Fund and the recommended VC FoF. This division allows for the participation of donors whose mandates do not allow for-profit investment or any form of ownership in the enterprises they support. It also helps to limit the potential for conflicts of interest.

9.2.8 Enhance, Modify and Adopt the Tax-Related Incentives

In the Startup Act, the Government proposes tax breaks for startups, innovative businesses, and ecosystem builders and incubators. Such a policy would help to reduce the drain on capital that endangers many early-stage businesses as they struggle to become profitable.

The suggested "Incentives for Investors", including a reduction in the tax on capital gains and a carry-forward loss provision for angel investors, are also timely and will serve to greatly improve the startup investment climate.

In addition: The incentives for investors should be expanded to encompass investments in regional or national digital infrastructure such as internet and telecommunications.

In addition: A short lifecycle, stand-alone Tax Refunds Fund should be established to reimburse startups for the taxes they will have to continue to pay until the Ministry of Finance is able to make the necessary changes to the tax code. As this Fund would be disbursing monies almost immediately and would have a short lifespan, it should be invested in easily cashable, secure investments and not structured for long-term sustainability. This recommended fund is discussed in more detail in Section 6.2.2.2.

Suggested modification: The Government should not extend the tax reporting period for startups and innovative business. It is strongly recommended that these businesses are still required to adhere to all standard business reporting requirements to build management skills.

9.2.8.1 International Precedents

India	Startup India offers generous tax support along with multiple specialised tax exemptions, including reductions on income tax, to all companies in the program. The government also provides incentives for investors, including tax exemptions on long-term capital gains.[93]

[93] "Startup Recognition & Tax Exemption," Startup India, accessed October 4, 2021, https://www.startupindia.gov.in/content/sih/en/startupgov/startup-recognition-page.html.

Singapore's Tax Exemption Scheme for New Startups provides for a competitive corporate tax rate, a line of tax exemption schemes and numerous tax incentives aimed at attracting new businesses and retaining thriving companies. The World Bank's annual Doing Business Report has ranked Singapore as the world's easiest place to conduct business for nine consecutive years, and the Tax Exemption Scheme has been highlighted as a major contributor to Singapore's pro-enterprise environment.[94]	**Singapore**

Amazon.com	One of the reasons for the initial success of e-commerce giant Amazon is that it received far larger tax breaks than it would have had if it operated a chain of brick & mortar bookshops. In addition to these corporate tax advantages, Amazon and other e-commerce operations also benefited from sales tax exemptions offered to their customers in several US States. Amazon further minimised its tax bill by reinvesting profits in its operations. Arguably, had Amazon not been offered these tax advantages, it would have had less incentive to reinvest and thus foster growth in its online ecosystem of businesses and in the cities in which it operates.[95]

9.2.9 Enhance, Modify and Adopt the Changes to the Business Registration Process.

Throughout the Startup Act, the Government indicates its intention to ease the path to entrepreneurship by simplifying and enhancing the company registration process. The planned replacement of paper-based forms with a digital application platform is certain to reduce errors and speed the process.

In addition: The Government should be certain to design the digital registry platform to enable the appropriate exchange of information between the registry and other

[94] Hsin Yee Wong and Stephen Lam, "How Tax Can Help Anchor Singapore as the Start-up Hub of Choice," EY Singapore, February 15, 2021, https://www.ey.com/en_sg/singapore-budget-2021/how-tax-can-help-anchor-singapore-as-the-start-up-hub-of-choice.

[95] Stephanie Denning, "Why Amazon Pays No Corporate Taxes," Forbes (Forbes Magazine, February 25, 2019), https://www.forbes.com/sites/stephaniedenning/2019/02/22/why-amazon-pays-no-corporate-taxes/?sh=2f0af42f54d5.

Matthew Haag, "Amazon's Tax Breaks and Incentives Were Big. Hudson Yards' Are Bigger.," The New York Times (The New York Times, March 9, 2019), https://www.nytimes.com/2019/03/09/nyregion/hudson-yards-new-york-tax-breaks.html.

authorities and regulators. This could give rise to services such as prepopulated forms for online tax filing, as have been widely adopted in the UK.[96]

Suggested modification: The proposed registration process involves pre-registration with the Ministry of Innovation and Technology, registration of competence based on "certificates of competence" issued by unspecified government agencies, and final commercial registration by the Ministry of Trade and Industry. This seems unnecessarily complex and time-consuming. It is recommended that the entire process of registering startups resides solely with the Ministry of Innovation and Technology, which could then assign a sponsor to help candidates through the process. Once the enterprises have passed their 5-year window and become ineligible for the startup label, they could then be required to register with the Ministry of Trade and Industry.

Suggested modification: The ministries and agencies responsible for both the pre-registration and the commercial registration of startups should commit to a faster registration cycle than the one calendar month promised in the Startup Act.

[96] "Finance (No. 2) Act 2017," Legislation.gov.uk (Queen's Printer of Acts of Parliament, November 16, 2017), https://www.legislation.gov.uk/ukpga/2017/32/contents/enacted/data.htm ; &

"Overview of Making Tax Digital," GOV.UK, November 12, 2020, https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital#making-tax-digital-for-income-tax.

9.2.10 Enhance, Modify and Adopt the Proposal for a Dedicated Institution for Startup Policy

"The Startup Act creates the National Startup Council (the Council) with the powers to:

(a) ensure that national startup program and the innovation fund are aligned with and contribute to national economic goals,

(b) identify obstacles in the public and private sector that hamper innovation,

(c) initiate audits of support and incentives provided, review audit reports and ensure that the necessary actions are taken according to the recommendations thereof,

(d) advise the Government on policy matters related to entrepreneurs, startups, innovative businesses, eco-system builders, investors and the Fund,

(e) cause the consolidation and publication of audited annual accounts of the Fund, and

(f) perform other activities which are deemed necessary for the performance of its functions."[97]

The establishment of a dedicated institution to advise on all matters relating to the startup ecosystem is an excellent way to establish an official voice for the ecosystem within the Government that many of the interviewed stakeholders felt was missing.

In addition: The Council should work closely with Government ministries, institutions, and regulators (including the National Bank of Ethiopia, Ministry of Education, and regional governments), to elevate and address startup-specific concerns across the public sector.

In addition: The Council should also work with private sector associations to develop and propose schemes and policies that promote the growth and welfare of the startup ecosystem.

In addition: The Council should establish an ombudsman unit to deal with industry complaints and issues swiftly and objectively.

In addition: The Council should take action to facilitate guidance for the demarcation of regulatory boundaries for technology-enabled businesses. This would help address the common stakeholder concern that most entrepreneurs do not know whom to approach

[97] Startup Act, Part Two, Section 6.1

about regulatory questions or approvals as it is often unclear which entity governs their business.

Suggested modification: The Council should include private sector representatives from successful innovative businesses, along with ecosystem builders and representatives from the Ministry of Finance and the Ministry of Trade and Industry.