

Term of Reference to Hire Legal Consultant

for

Establishing Credit Guarantee Scheme in Ethiopia

1. BACKGROUND AND CONTEXT

1.1. MSMEs and Financial Accessibility

Unemployment and underemployment continue to be serious social challenge in Ethiopia. This problem is even more aggravated with an alarming number of new graduates joining the labour force every year. Therefore, in Ethiopia, the agenda of creating job opportunity for the young people has been a focal point of political and economic agenda. The increasing population with large portion being youth population is considered as opportunities and challenges to Ethiopia with an estimated amount of two million young people expected to join the labour market each year.

It has been also acknowledged that start-ups and small businesses have great potential to create job opportunities for these group and contribute for economic growth. In emerging economies, studies shows that start-ups and small business could contribute to 60% of total employment and 40% of gross domestic production¹. Increased access to finance allows small businesses to undertake productive investments and contribute to the development of the national economy and reduce of poverty.

Cognizant of their significance, the MSME sector has been recognized by the government of Ethiopia as a driver for economic growth and job creation. To that end, the government has invested heavily to support MSMEs through designed and implemented a National MSE Development Strategy, provision of work premises, skill trainings, production support, access to finance and marketing support.

However, despite the GOE's special focus on MSME development, Ethiopia has one of the lowest entrepreneurial activities in Sub-Saharan Africa. According to 2012 data from the Global Entrepreneurship Monitor (GEM), only 12% of Ethiopia's adult population were in the process of starting a new business or running businesses².

Access to finance is a structural challenge faced by MSME in the Ethiopian economy. The financial sector remains under-developed in Ethiopia; in the 2017-18 Global Competitiveness Report, Ethiopia ranked 109 out of 137 countries in terms of financial market development and only 16% of the private sector uses finance from banks for its activities, compared with Kenya where the figure is 41%.³ In Ethiopia's rural economy, a combination of high collateral requirements, poorly designed lending products, and an unwillingness of rural households to borrow money limit the diversification of rural livelihoods. SMEs financing challenges arise from both the demand and supply side:

¹ World Bank Small and Medium Enterprises "SME" Finance, 2015. Retrieved from: <https://www.worldbank.org>

² Start-up Ranking; Global Entrepreneurship Monitor; 2012; Retrieved from: <https://www.gemconsortium.org>, Sep 2021

³ World Bank, Doing Business 2020: Economy Profile of Ethiopia, accessed at <http://www.doingbusiness.org>

1.1.1. Demand for finance

Demand for finance challenges mostly arises from: Lack of collateral, Strong information asymmetry: lack of track record to assess risk, High cost of doing business and lack of access to markets like suffer from lack of network across value chain actors and general restrictiveness regulatory environment and Poor financial and management skills.

A study conducted to analyze barriers to growth of SMEs in Ethiopia found that strong competition in markets and poor infrastructure are the major barriers followed by access to finance related challenges such as high level of interest rates and loans and speed of debt repayment, unavailability of appropriate property (Amentie, Negash and Kumera, 2016). A CSA survey on small manufacturing enterprises also reached on the same conclusion; 42% of enterprises surveyed reported lack of insufficient capital as a major problem faced at the start of operation while 66% highlighted insufficient loan and high interest rates as major challenges in accessing working capital (CSA, 2016/17).

1.1.2. Supply of finance

Supply of finance challenges are arising from Higher cost of lending (acquisition, costly distribution networks, small size of transaction), Higher levels of risk due to poor credit information system, Weak SMEs finance culture and business model adapted to SMEs, Financial institution business models being mostly inadequate to serve SMEs. Bank loans are inaccessible to SMEs due to high collateral requirement, weak SME finance culture and poor financial management skills of most SMEs. And, while microfinance loan has grown from; most credit is group-based, requires fixed-asset collateral and suffers from relatively short loan repayment period and limited product diversification.

Generally, the challenge of accessing finance by MSME in Ethiopia highlights that the need for specificity in looking at alternative financing for MSMEs is the means to unlock job creation performance and economic growth challenges, that takes into consideration the economic, regulatory, institutional and operational dynamics at national level. Accordingly, many of most reasons, establishing Credit Guarantee scheme at national level will be the solution to unlock the challenges of financial access for MSME.

Guarantee Schemes are a popular instrument that existed since the 19th century, with the objective of increasing access to finance to enterprises. In these schemes, a third party, "the guarantor" promises to pay back the lender a part of the total amount of the loan in case of a default of the borrower. In the exchange of this service, the guarantor collects a fee from the lender. With such an arrangement, the credit risk and the loan loss provisions of the lender are lower, and therefore the requirements for collateral are lower, and the profits and capital levels are higher. As a result, constrained firms have a higher probability of accessing loans from lenders benefitting from such schemes.

It is envisaged that establishment of the CGS would certainly widen the opportunities of MSMEs in accessing finance which Ministry of Labour and Skills (MoLS) took the initiative to develop a high level concept note identifying the need for its establishment, the impact of the youth revolving fund on A2F, other countries experience and recommendations on the need to establish the CGS with alternative modalities. To move the initiative forward, MoLS partnered with FC/ DAI- BRIDGES program to develop the workplan, and more specifically to assist on technical provision aspect of the initiative specifically on developing the legal framework and designing of financial and operational modalities of the CGS and

hence a task team comprising both team experts was formed to do the specific tasks mentioned below in part #4.

The BRIDGES Programme implemented by First Consult is a five-year youth job creation initiative addressing fundamental, immediate, and complementary challenges to unlock the potential for job creation within industrial parks (IPs), as well as outside the IPs, including micro, small, and medium Enterprises (MSMEs). As such, BRIDGES also plans to train 300,000 unemployed young men and women through industrial park job creation initiatives, and market linkage between industrial parks and MSMEs.

2. Rational of Establishing Credit Guarantee Scheme

Ethiopia's economy has been among the fastest growing in the world registering a double-digit growth consistently for the past 15 years. Despite this stellar performance, as discussed in previous sections access to finance has been a challenge in Ethiopia. The Government of Ethiopia has historically been supporting enterprise development through its flagship policy and programs such as MSME development strategy most recently coupled with a finance support through the Youth Revolving Fund. Through this support, thousands of micro and small enterprises were established with millions of jobs created. However, a deeper analysis to the financial support provided through revolving fund shows low repayment rates in most regions, which highly jeopardises the financial sustainability of the fund.

In 2019/20 FY, the government through MoLS leaderships targeted to create 14 million jobs by 2025 by aiming to foster the business environment and conditions necessary, to absorb the currently unemployed, and to ensure that sustainable jobs are created for new entrants to the labour force. This target cannot be achieved only through wage employment as there are limited number of enterprises that can absorb this labour force. Therefore, there is a need to ignite the entrepreneurship ecosystem with a focus on ensuring high growth entrepreneurs get the opportunity to bloom, create jobs and contribute heavily to the economy.

Start-ups and smaller firms are much more likely to be rejected for a loan or a line of credit than firms who are more established or larger. This is because the FI's is still less competitive, less efficient, and with limited outreach. The financial institutions including MFI's do not bother to take risk by working with MSMEs (enterprises who can not avail collateral for the loan) due to high demand for loan.

Credit Guarantee Scheme is proposed to be established with the objective of increasing access to finance to enterprises introducing a third party, "the guarantor" promises to pay back the lender a part of the total amount of the loan in case of a default of the borrower. In the exchange of this service, the guarantor collects a fee from the lender. With such an arrangement, the credit risk and the loan loss provisions of the lender are lower, and therefore the requirements for collateral are lower, and the profits and capital levels are higher. As a result, firms constrained from taking loan because of firms have a higher probability of accessing loans from lenders benefitting from such schemes.

Credit Guarantee Schemes are an increasingly popular instrument used by public authorities to improve MSMEs access to finance and tackle market failures. From a theoretical perspective, the Guarantee schemes exist for three main reasons (Honohan 2010). The first reason is a principal-agent problem: the

guarantor could have an information or enforcement advantage over lenders, typically in the case of high information asymmetry between lenders and borrowers, that lead to the exclusion of creditworthy borrowers. The second reason is that the guarantor could have a better capacity to spread and to diversify risks than lenders. The third reason is that credit guarantees can sometimes be used for regulatory arbitrage when, for instance, the guarantor faces different regulations than lenders and can provide guarantees that lenders can't provide for regulatory reasons.

The involvement of government in guarantee schemes can be driven by the first and second reasons. In general, governments do not have an information advantage over lenders, compared to business associations or other forms of organisations who would gather information about businesses, and typically involved in a mutual guarantee scheme. However, in a situation where information asymmetry is relatively high, their intervention can help lenders build knowledge and reduce this asymmetry, and therefore reduce the number of excluded creditworthy borrowers. Also, governments tend to have a better ability to take risks and to diversify their risks than financial institutions, especially in the context of low-income countries, where the financial sector remains under-developed.

Therefore, Credit Guarantee Schemes are expected to provide financial and economic additionalities. Financial additionality is defined by improved access to finance of constrained firms, and economic additionality by increasing the contribution of guaranteed SMEs to exports, job creation, value addition, and other economic outputs.

Hence, this requires establishing national wide credit guarantee scheme which takes into account bringing sustainable solution for challenges related to access to credit for early-stage enterprises for them be able to grow and generate income. To this effect, the scheme needs to be established in comprehensive and sustainable manner plan with clear implementation manual.

3. OBJECTIVE OF ESTABLISHING CREDIT GURANTEE SCHEME

Given this background, the Ministry of Labor and Skills is seeking technical support from partners to develop detail technical proposal and implementation modality for successfully establishing the scheme in Ethiopia to support its endeavor of unlocking access to finance challenge and resource optimization opportunities for job creation agenda of the country.

The then JCC, now Ministry of Labor and Skills in collaboration with FC-BRIDGES mapped out the workplan in regards to establishing CGS nationally and on of the milestones is to provide Technical Assistance in hiring a Legal Advisor to draft the credit guarantee Scheme proclamation and directive.

4. SCOPE OF WORK for the Legal Adviser

- Diagnose macroeconomic, regulatory and institutional factors for the current CGS implementation experience in Ethiopia

- Assess and understand the current financial sector governing legal frameworks of Ethiopia
- Assess international best practice legal frame of some relevant countries and understand the legal frameworks managing guarantee schemes
- Assess the current state and expected trends regarding the legality of CGS through reviewing existing CGS progressive report, policies related to this platform and legal framework in financing development ecosystem.
 - Existing Domestic legal framework and supportive policy issues: including the enabling policies/government strategy, operational and financial management in the country
 - Reviewing International experience of policy and legal frame work related issue for the establishment of CGS and highest success of its implementation.
- Identify and recommend the types of CGS and its advantages and disadvantages for our country legal context.
- Contact all relevant experts and offices for understanding the overall legal framework
- Draft the proclamation/regulation for the establishment and legal procedures to be endorsed by the Council of Ministers/House of Peoples’ Representatives for the establishment of the credit guarantee scheme, present it to the task team, validate the work and submit the report
- Collaborate with the Business adviser to understand the business, operational and administrative aspect of the credit guarantee initiative
- Any other relevant tasks assigned by the taskforce

5. EXPECTED DELIVERABLES

A comprehensive work plan that includes an overview of the existing situation, an analysis of the business and financial eco-system of the country. A draft proclamation/regulation for the establishment and legal procedures to be endorsed by the Council of Ministers/House of Peoples’ Representatives for establishing credit guarantee Moreover, the expert will prepare presentation material for workshop and present it to the relevant stakeholders both an Amharic and English final version of the proclamation in soft and hard copy.

6. DURATION OF THE DELIVERABLES AND TIMELINE

The Consultant will be expected to complete the write up of the detail technical document and submit the final corrected copy within a period of 30 working days from the date of signing of the contract as per the following time frame.

No.	Main Deliverables	Working Days Allocated
1.	Preparation of work plan, outline and submission of inception report	2
2.	Review of all relevant documents – desk review	7

3.	Draft the legal proclamation	7
4.	Consultation with relevant stakeholders	3
5.	Finalize the legal proclamation and present to the task force	2
6.	Organize workshop with key stakeholders for final validation	2
7.	Incorporate comments and submit final proclamation (both in Amharic and English version with soft and hard copy)	2
	Total	25

7. REQUIRED QUALIFICATION AND EXPERIENCE

The potential candidates must have the following qualifications and experience:

- Master's Degree in Law,
- More than 15 years of advisory experience in commercial law
- Prior Experience in drafting proclamations
- Good understanding of the Ethiopian commercial code, business environment
- Good understanding and more than 5 years of experience in the banking sector (especially on credit facility and loan recovery) and/or insurance industry

Good understanding and knowledge of organizational structure of key government stakeholders, private sector and financial institutions

- Good understanding and knowledge of organizational structure

8. DOCUMENT SUBMISSION AND DEADLINE

The potential candidate must submit the following documents:

1. Technical proposal (not exceeding 5 pages) encompassing understanding of the TOR, approaches and methodology for the envisioned service and expected deliverables.
2. Financial proposal incorporating the daily rates
3. Curriculum vitae

Deadline for submission of the aforementioned documents will be March 08, 2022 via the following email address bids4@firstconsultet.com