



At September's International Growth Centre conference at LSE, **John Sutton** explained how his enterprise map project in Ethiopia has exploded myths about how successful companies develop in sub-Saharan Africa. He talks to **Joanna Bale** about the project, and about his new book on Ethiopia.

Joanna Bale: Professor Sutton, what inspired this project?

John Sutton: I had wanted for quite a number of years to carry over the work I've done on the development of firms and industries to the context of sub-Saharan Africa. I found, however, that it was extremely difficult to obtain sources of information of the kind that I would have easy access to in a European country. It also seemed to me that the type of information that would actually be useful to an economist or policy maker in relation to framing enterprise policy in these countries was neither terribly extensive, nor necessarily overly expensive to put together if the project was tackled in the right way. So I went to the IGC steering committee a year ago and suggested that I carry out this project in Ethiopia in order to provide a template of future studies of this kind.

JB: What did you actually do?

JS: The idea was to begin from the observation that a country like Ethiopia will have no more than 30 or 40 companies dominating its manufacturing activity and, in particular, its manufacturing exports. So by taking the country's major industries one by one and identifying the leading companies, we end up with 50 large companies spread over some eight or ten industries. The idea is then to build up a detailed profile of each of those industries setting out the firms, their activities, the products, identifying different clusters of firms that play different roles in the industry, looking at the way supply chains in the industry interact and how the industry is linked in with other industries in the country

and so on. And then, having done that, to produce full profiles of a handful of leading firms in the industry. The key thing about these profiles is that it tells us where the firms' capabilities came from and this is a key to understanding how such capabilities might be fostered and developed in the future.

JB: What do you mean by capabilities?

JS: The word is widely used and often used in somewhat different senses by different people. As an economist, what I mean is something very simple. I mean the set of skills possessed jointly by people in the company. These skills are manifested in three things: the firm's productivity, the firm's quality level, and the range of products the firm is producing.

JB: So where do the capabilities come from?

JS: I will have to tell you this in a number of steps. If you look at these 50 leading companies they break down into three groups. The first quarter had their origins in the public sector, the second quarter had their origins in foreign companies, and the remaining half are the domestic private sector companies – and this is where things get interesting. In the case of the domestic private sector companies in Ethiopia, there's a surprise. It turns out that almost all, in fact 24 out of 26 of these companies, had their origins in the trading sector. In other words, an import/export business, in practice mostly importing goods, had been in existence for a generation or more. And this trading company decided to enter manufacturing.

JB: Why is that a surprise?

JS: There is a very strong tendency in some circles to treat trading companies as being of secondary importance and to emphasise the role of manufacturing as a driver of growth. It is all very well until you realise that these trading companies turn out to be the seed corn from which successful manufacturers are grown.

JB: Why does that matter?

JS: It matters because it teaches us what the scarce resource is, and as an economist, I am always looking for the scarce resource. What is it that a developing country doesn't have that the average European country does? There have been fashions in economics emphasising different missing things. For instance, in the 1960s, everyone thought that these countries needed more capital stock. Attempts to simply build factories by the World Bank in Tanzania, for instance, led simply to inefficient or sometimes completely empty factories. Capital was not the missing element. What these trading companies are now emphasising is something that has become commonplace in my area of economics in the past few years. The really scarce and valuable thing lies in the ability of individuals and groups to run a well functioning company – and that brings me back to the trading companies.

Most people when confronted by this fact say the trading companies just have access to finance, which is true. They do indeed have cash flow from their trading business, but that's not the important thing. The important thing is that they have two things that are really scarce and valuable. The first is this organisation ability to run

a mid-size company well. The second is uncannily good market intelligence, that is, an understanding of the markets in which they are operating.

JB: How does this market intelligence work?

JS: Let me give you an example of what happens when you operate without it. A firm set out to make matchboxes in Ethiopia some years ago, and was very pleased to push its unit costs of production down to 38 Ethiopian birr. A month after opening, they received an offer from China to produce similar matchboxes at a delivered price of eight birr. Getting into import substitution is extremely hazardous. You can easily be undercut by cheap imports at any point.

What these ex-trader companies have is a strong sense of what market niche they can safely fill to produce a long-term viable business. Now, let me give you a positive example: Mohan Kothari Group began as a trading company in Ethiopia more than a generation ago. Recently it has entered manufacturing in a number of areas. One of its successful companies makes drawn steel wire, a standard industrial product for which there is considerable demand in Ethiopia. It was formerly mostly imported, so how can it be profitable to produce it locally? What the Mohan Kothari Group realised is that products of this kind are subject to intense import competition, mostly from China. But it also knows enough of the international market to realise that the steel bar which is the raw material input for this product is in short supply within China itself, so the Chinese are currently importing this grade of steel bar from the Ukraine. The Ethiopian group can equally well import on the same terms from the Ukraine, so here is a case where it is not going to be undercut and the business will be stable.

It is this kind of uncannily good market intelligence that is commonplace in these ex-trading firms. They know the ins and outs of prices and supplies of the international market to an extraordinary degree. That is one of their big assets.

JB: So what about the other asset you mentioned earlier: organisational ability?

JS: Here I am going to turn to a second aspect of things in order to underline the importance of this. In parallel with my study, Måns Söderbom of Gothenburg University in Sweden looked at industry in Ethiopia through the opposite end of the telescope by carrying out a statistical analysis of small and medium-sized companies across Ethiopian manufacturing. What he found gelled exactly with what I had found.

Of my 26 large private sector companies across the industrial sector (agri-business, manufacturing and

construction), I found that only two had begun as small industrial companies. This goes against a widespread impression that mid-sized and large-sized manufacturing firms grow for the most part from manufacturing firms that begin as a small size.

What Måns found, in following a cohort of all 55 companies that entered Ethiopian manufacturing in 1989, was that virtually all of the companies that began with fewer than 15 employees had failed within ten years. Companies that had started with 15 to 50 employees, however, had a very high survival rate.

It seems that we should not be surprised that a high proportion of firms fail. Seventy per cent of all new business entrants in Western countries fail within five years. What is interesting is the role of initial size. The small firms that begin with fewer than ten employees do not usually have the organisation, ability or skills to grow to become a mid-size or large company in the medium term. This organisational capital is crucial and that is the second ingredient that the trading companies bring. They are already long-lived, mid-sized or larger companies that know how to organise their affairs very effectively and efficiently.

JB: Did you learn anything else from this study?

JS: The other thing we learned related to the role played by foreign companies in the country. I surveyed all the 200 or so companies spread across ten industries that have recently established FDI (foreign direct investment) projects with Ethiopia. These companies represent an important part of Ethiopia's industrial future.

JB: That goes a little against conventional wisdom doesn't it?

JS: Yes, there's been a great deal of pessimism about FDI in sub-Saharan Africa. FDI flows have been going very heavily towards China and India over the past decade and people have been disappointed about the size of flows into the African countries. Yet when I look at the current stock of foreign companies with new projects in Ethiopia, it turns out that these are mostly mid-sized manufacturing activities and that the total projected employment from these, 26,000, is about the same as the total employment in Ethiopia's 50 biggest industrial companies, so we are talking about big numbers in terms of potential future employment.

JB: So what are the issues here?

JS: The issues relate to the way in which Ethiopia frames the business environment for companies. Countries around the world have learned, for the past 50 years, that creating a healthy interface between government and foreign companies is a really important investment

for a country to make, both because it preserves employment within the existing stock of FDI companies and encourages future FDI flows. And this is one of the things that is going to matter a great deal to Ethiopia over the next few years.

JB: So you are done with Ethiopia?

JS: Yes, the project is finished and the book, *An Enterprise Map of Ethiopia*, was published in November 2010. The full version of the enterprise map volume was delivered to the office of the prime minister of Ethiopia in July this year and was the subject of a series of meetings in Addis Ababa which involved business people, representatives of government and academics from Ethiopia and abroad. The final published version has been edited to remove commercially sensitive information.

JB: So what's next?

JS: The idea is to replicate this study across a number of countries. I am expecting to begin work on Ghana early in the New Year. I am hoping that some of my colleagues might be persuaded to do the same job for other countries, but I haven't succeeded in recruiting anyone yet! ■



Professor Sutton is the Sir John Hicks Professor of Economics at LSE, where he directs the economics of industry group at STICERD (Suntory and Toyota International Centres for Economics and Related Disciplines). Professor Sutton's Ethiopia project was carried out jointly with Nebil Kellow, who is co-author of the book and managing director of First Consult, Addis Adaba.



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An Enterprise Map of Ethiopia is published by the International Growth Centre in association with the London Publishing Partnership. Hard copy versions are available from Central Books, see [http://](http://tinyurl.com/igc-ethiopia)

tinyurl.com/igc-ethiopia. You can download the text for free at personal.lse.ac.uk/sutton

