

News or Noise Special Report: Adam Smith's Ideas ... Alive and Well in Ethiopia

By David Fisher, Chief Investment Officer

Three members of the SignatureFD team recently journeyed to Ethiopia with several clients. The objective was to complete “boots on the ground” due diligence on a group we had been tracking for more than a year—[Renew Strategies](#). Laura and Matt Davis of Renew were our hosts for the week, and they along with their entire team did a fantastic job.

Our trip was filled with education, culture and discoveries, but my focus in this report is to make a connection between the Scottish Enlightenment and our observations in Ethiopia—a connection that I had not planned on. By coincidence, a client had sent me a copy of a book titled *How the Scots Invented the Modern World* by Arthur Herman that I happened to throw in my bag for the 13-hour flight. As I would more fully appreciate after reading the book, the influence that many of the top thought leaders in Scotland had on the world during the volatile 18th century was impressive. But as we landed in Addis Ababa, Ethiopia's capital, and started our adventure, I continuously returned to the lessons of two such Scottish thinkers.

Francis Hutcheson and Impact Investing

Francis Hutcheson is considered to be one of the founding fathers of the Scottish Enlightenment, the style of modern thought that emerged from Scotland in the early 1700s. He was well regarded as a lecturer and was the Chair of Moral Philosophy at the University of Glasgow from 1729 until his death in 1746. It was during those years that he built on the



“ Impact investing is about taking the lessons learned from operating within a democratic and free market system and sharing those with others around the world.”

ideas of philosopher John Locke and others and fundamentally changed people's views of ethics, politics and economics. Hutcheson influenced many future leaders of the Enlightenment, including Adam Smith and David Hume.

As I mentioned, we were hosted in Ethiopia by the team at Renew Strategies. Renew is working to create a new model for impact investing in a part of the world that is desperate for entrepreneurial input and growth capital for small and mid-sized companies. It is in this field of impact investing that I first drew on ideas from the Scottish Enlightenment. At one point, one of the clients traveling with us said that it made little sense that he was spending a week of his life to travel halfway around the world to check on what would probably become one of the smallest investments in his portfolio. Yet, at the same time, this client was thoroughly enjoying the experience. It was then that I made the connection between impact investing and Hutcheson's views.

In his book, Herman shows us how self-interest and altruism can be reconciled in Hutcheson's theories:

Self-interest and altruism are no longer at odds. In our highest moral state they merge and become "two forces compelling the same body to motion." They form "an invariable constant impulse towards one's own perfection and happiness of the highest kind" and "toward the happiness of others." Virtue is indeed its own reward. But it is the highest reward of all—a contented mind and soul.¹

The concept of impact investing is different from making an investment in nameless, faceless companies or businesses that are acting in hypercompetitive markets of the developed West. In Ethiopia, it is abundantly clear how any investment can have a significant impact on the local economy.

Ethiopia is a country with nearly 100 million people. From 1974 until 1991, it was ruled by a militaristic and communist-leaning regime called the Derg. The regime was weakened by the impact of the dramatic famine to strike the country in the 1980s, and it eventually fell in 1991. The current ruling party is not a fully Western-style democracy but has looked to the West for support and has embarked on significant economic reforms, which have shown great improvement. Because of the size of its population, its economic reforms and its increasing integration within the global economy, Ethiopia is a natural market for impact-investing strategies.²

As someone who has always enjoyed—and too often taken for granted—freedom and economic comfort, I found it eye opening to witness the innate desire of people to advance in life. Again, Hutcheson spoke of this, and his ideas were instrumental in the formation of our own country and much of classical liberalism:

*Hutcheson's doctrine of happiness, then, had two faces. It involved, on one side, gratification of the self through a joyous and contented life. When Thomas Jefferson added "the pursuit of happiness" to his list of inalienable rights of man in the Declaration of Independence, he was emphasizing this side of Hutcheson's legacy. On the other, it was also intensely altruistic. No man stands alone, was the message his students absorbed. Hutcheson constantly enjoins us to **get out and become involved in the lives of our fellow human beings (emphasis added)**.³*

Impact investing is about taking the lessons learned from operating within a democratic and free market system and sharing those with others around the world. Further, it can't be done from the comfort of our own place but requires us to get out and get involved as Hutcheson suggests.

Adam Smith and the Ethiopian Economy

The other lesson learned on this trip is that human beings, when left to their own devices, will go to extraordinary measures to improve their position in life. There is a deep-rooted urge within all of us to improve our situation for our families and to leave the world a better place.

Adam Smith is probably the most famous thinker of the Scottish Enlightenment and may be the single most important person in the development of what we now call the free market economic system. As I observed the citizens, business leaders and investors in Ethiopia, I discovered a new perspective on what Smith wrote in his most famous book, *The Wealth of Nations*:

The natural effort of every individual to better his own condition ... is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations.⁴

Since Ethiopia embarked on economic reforms nearly 20 years ago, its economy has been one of the fastest growing in the world. But even after years of strong growth, the country has an annual GDP per capita of just \$1,300, which means this nation—which is twice the landmass of Texas and with a population that is almost as large as California, Texas, Florida and New York combined—has an economy comparable with South Dakota. But based on our trip, we left Ethiopia believing that it will continue to develop.

Here are economic observations from our trip:

Infrastructure matters. One of the biggest reasons that emerging countries can't compete is a lack of infrastructure. Poor roads, spotty communications and power blackouts all make doing business difficult.

Infrastructure is improving in Ethiopia. The Chinese have been big investors, helping Ethiopia complete the Addis-Adama expressway, the first modern freeway in the country.⁵ A new railroad is also being constructed between Addis Ababa and Djibouti and is scheduled to open in 2016.⁶ We heard that these transportation improvements should reduce the travel time between Addis

Ababa and Djibouti, the primary port of entry for goods in and out of Ethiopia, from two days to eight hours.

The United States is providing help to Ethiopia and other countries in sub-Saharan Africa through the program Power Africa. “The initiative aims to double access to power in Sub-Saharan Africa by 2018.”⁷ Finally, the telecommunication system in Ethiopia is lagging, but it will eventually catch up. Generally speaking, many countries in Africa have essentially leap-frogged the West when it comes to communications, bypassing development of hardline communications and going straight to high-speed wireless. “In 2001, only 25 million Africans had a mobile phone subscription; today, Africa has over 650 million subscriptions.”⁸

What we observed is that though infrastructure is still behind that of the West, Ethiopia is catching up quickly.

Government matters. Government involvement, or lack thereof, plays a big role in how efficiently an economy can operate. For decades, many emerging countries have been weakened by corruption and bureaucratic red tape. Though Ethiopia is challenged by bureaucracy, the leaders have done a fairly good job of controlling corruption.

Even with improvements, Ethiopia ranks 132nd in the world in “ease of doing business” according to the World Bank.⁹ But a recent Brookings report states that sub-Saharan Africa accounts for “the largest number globally of regulatory reforms that reduced the cost of doing business.”¹⁰ Finally, Ethiopia just this month announced that the country is partnering with the United Nations to further develop rules around consumer protection and business competition. The goal is to “protect the business community from anti-competitive and unfair market practices, and also consumers from misleading market conducts.”¹¹

Capital matters. Capital clearly matters, and it is probably Ethiopia’s largest need. There are generally large global investors or government-sponsored groups that can handle the big investments in infrastructure, banking, and energy and mining. Local investors or global microfinance organizations can often fund the very small businesses. But the midsized private companies often lack access to capital. According to the team at Renew, “In the U.S. and other developed countries small and medium enterprises (SMEs) make up a majority of our economy and can get affordable small business loans. This is not the case in developing countries. In cities like Addis Ababa, Kampala and Dakar, growth capital is the greatest barrier preventing SMEs from employing hundreds and thousands of people.”¹²

Ethiopia is improving on this front as well. A major driver of this is the African Growth and Opportunity Act, which is focused on boosting trade with Africa through duty-free trade access. According to Brookings, non-oil exports from Africa to the U.S. have grown “from around \$1 billion in 2001 to over \$4.7 billion in 2013.”¹³

At SignatureFD we have been studying the investment opportunity in frontier markets for many years. Goldman Sachs published a report in 2005 titled *N-11*, focusing on a group of countries that could eventually replace the role that China has played in the global economy for the past

two decades. Though no single country has the size and potential that China had in 1991, these 11 countries in aggregate are comparable. This is an investment theme that we believe can last for many years, possibly a decade or more. Our trip to Ethiopia strengthened our conviction in the organic growth potential of this theme—and wasn't a surprise. What was a surprise was the relevance of the centuries-old core philosophies of Hutcheson and Smith to modern-day Ethiopia—specifically, the ability for investors to simultaneously search for personal gratification and remain altruistic in their actions, and for the people of Ethiopia to use all their available resources, which seem meager by our standards, to better their position in life.

Sources

1. Arthur Herman, *How the Scots Invented the Modern World*, New York: Crown Publishing Group, 2001, 76.
2. "History of Ethiopia," *Wikipedia*, last modified March 21, 2015, http://en.wikipedia.org/wiki/History_of_Ethiopia.
3. Herman, *How the Scots Invented the Modern World*, 83.
4. Herman, *How the Scots Invented the Modern World*, 197.
5. Clementine Logan, "Chinese Company Undertakes Design and Maintenance of 1st Highway in Ethiopia," *CCTV.com*, May 6, 2015, <http://english.cntv.cn/2014/05/06/VIDE1399348085131173.shtml>.
6. Matthew Newsome, "New Rail Project in Ethiopia Evokes Memories of Glory Days," *RFI*, August 26, 2013, <http://www.english.rfi.fr/africa/20130826-new-rail-project-ethiopia-evokes-memories-glory-days>.
7. Tony O. Elumelu, "Africa Is Open for Business, Ready for Investment," *The Wall Street Journal*, July 31, 2014.
8. Michael Hastings, "Seven Reasons to Be Optimistic About Africa," *This Is Africa*, July 4, 2014.
9. World Bank Group, "Ease of Doing Business in Ethiopia," <http://www.doingbusiness.org/data/exploreeconomies/ethiopia/>.
10. Joshua Meltzer, *Reforming the African Growth and Opportunity Act to Grow Agriculture Trade*, Brookings, February 23, 2015.
11. Nathasha Turak, "Ethiopia Works on New Competition and Consumer Protection Rules," *This Is Africa*, March 16, 2015.
12. Renew, "Renew's Strategy: Minding the Investment Gap," <http://www.renewstrategies.com/new-strategy/new-strategy>.
13. Meltzer, *Reforming the African Growth and Opportunity Act to Grow Agriculture Trade*.

What Is News or Noise?

Like most of you, we are inundated with information on our phones, in our email inboxes and on the Internet. Clearly, the world doesn't need another investing blog to reprocess stale information or reformat the day's useless headlines. Thus, in our investment blog, "News or Noise," we've taken up the challenge of sorting through the infinite bits of background noise and seeking the few truly newsworthy nuggets of information. What are the stories today that are likely to be meaningful for investors in the future? A very small number of headlines are important, and of those, many are immediately processed by investors. Only a tiny fraction of all the new data is truly relevant and underappreciated.

Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by SignatureFD, LLC), or any non-investment related content, made reference to directly or indirectly in this blog will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this blog serves as the receipt of, or as a substitute for, personalized investment advice from SignatureFD, LLC. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. SignatureFD, LLC is neither a law firm nor a certified public accounting firm and no portion of the blog content should be construed as legal or accounting advice. A copy of the SignatureFD, LLC's current written disclosure statement discussing our advisory services and fees is available upon request.