

***The Role of Micro-Loans in the Growth of Small & Medium Enterprises (SME)  
in Addis Ababa City***

**By**

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***A Thesis Submitted to Department of Accounting and Finance***

***Addis Ababa University***

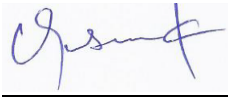
***In Partial Fulfillment of the Requirements for the Degree of Master of  
Science in Accounting and Finance***

**February 2024**

**Addis Ababa, Ethiopia**

## DECLARATION

I, Yisahak Yitagesu Abebe, hereby declare that this research presented is my original and any other work has been duly acknowledged. I also declare that this work has never been submitted partially or wholly to any institution anywhere and for any purpose. All materials used in the due process have been acknowledged well.



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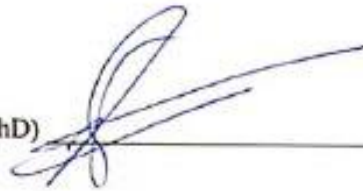
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## CERTIFICATION

This is to certify that this thesis entitled "The Role of Micro-Loans in the Growth of Small and Medium Enterprises (SMEs) in Addis Ababa City" submitted to the Addis Ababa University, College of Business and Economics in partial fulfillment of the requirements for the degree of Master of Science in Accounting and Finance and is a record of bonafide research work carried out by Mr. *Yisihak Yitagesu*, under my guidance and supervision. Therefore, I hereby declare that no part of this thesis has been submitted to any other university or institution for the award of any degree or diploma.

Advisor: Temesgen Worku (PhD)



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## ABSTRACT

*This research thesis is constructed to study the role of micro-loans provided by microfinance institutions & saving and credit associations in the growth of small & medium enterprises. To see the impact of micro-loans, the study measures the growth in income, capital, and asset of the enterprises through different mechanisms. This study follows a quantitative research format to analyze the data collected and an analytical research approach is used to present the results. The research was conducted by administering 181 forms of questionnaires and include secondary data found from the enterprises. The sampling technique applied in the study is convenience sampling. The finding of this study reveals that after the introduction of micro-loans by microfinance institutions many small and medium enterprises and individual entrepreneurs were able to satisfy their need for additional working capital. In addition to that, micro-loans have played a major role in the development and growth of these enterprises. As the finding of this study reveals the income, capital, and profit of the enterprises that are involved in accessing micro-loans have improved significantly. Moreover, the attitude of investing only own money by many individuals has changed and it is witnessed by the results observed in the capital structure change. Due to that the debt-to-equity ratio has been reversed through the five years under study.*

*Keywords:* micro-credit, small and medium enterprises, microfinance institutions

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## ACRONYMS

SME – Small and Medium Enterprises

MFI – Micro-finance Institutions

D/E – Debt to Equity Ratio

NGO – Non-Governmental Organizations

NBE – National Bank of Ethiopia

ILO – International Labor Organization

UN – United Nations



# CHAPETER ONE

## INTRODUCTION

One of the major problems encountered by small businesses and entrepreneurs in many parts of the world is the ability to generate initial and additional working capital for their investment. In many cases, it is difficult for these individuals or businesses to fulfill the requirements by regular commercial banks to be eligible for credits (Nithya & Hanan, 2020, Nur R. et al, 2017, Viviane,2004). Due to that many were forced to keep their ideas to themselves or see others do it in a wrong way. Entrepreneurs with little wealth, many of whom are women and fresh for business, frequently lack the start-up capital required to start a business, adequate credit for securing low-interest rate loans, or the institutional knowledge to access available resources (Wells Fargo, 2020)

Successfully investing in any business requires a solid business plan and a budget that accounts for the start-up costs. Once the expected start-up expenses are known and the budget is created, the next step will be looking for the initial capital. However, when the money in their bank is not enough for the initial investment, they begin to look around for other options and one of the easiest ways for this is to apply for micro-loans in microfinance institutions (Fadi & Deryl, 2007).

### **1.1. Background of the study**

In emerging nations, when the poor cannot afford to put up collateral for conventional financial services and transaction costs are too high, a lack of access to credit is commonly acknowledged as the primary factor contributing to poverty. The inability of the poor to get financial access brings light to the idea of financial inclusion which is the method of offering banking and financial services and solutions to every individual in society without any form of discrimination (Danam & Sunder, 2022). With the vision and mission to replace commercial banks, the main goal of

microcredit was to improve social welfare, including poverty reduction and social reform, and non-profit groups were the main participants (Le Thai, 2021).

In an ILO working paper published in 2013, it is stated that microloan is targeted at people who are mainly unemployed or otherwise excluded from the traditional banking system and who wish to start their own businesses. Added to this point Kazi (2010) stated that the small-scale loans that are availed through the microfinance institutions (MIFs) help the poor borrowers for income-generating self-employment projects. He also mentioned that for countries with huge populations who usually belong to the poorest communities, microcredit is very much their hope to expand their micro-enterprises, increase their labor productivity, and move up the income ladder gradually.

The United Nations (UN) poverty reduction models and policies place microcredits as one of the most efficient mechanisms to bring change to society (Samir et al., 2021). Emma (2007) also stated that microfinance has been used by NGOs, the UN, and other agencies intensively to give solutions for large-scale poorer groups that were previously excluded from access to capital and create a financial system to help them rise out of poverty by themselves.

The other issue mentioned by Asmamaw (2014) is microfinance not only fills the gap of conventional banks' limitations in reaching the poor and vulnerable but also is an effective intervention for empowering the poor in their economic and social encounters. Numerous researchers and policymakers contend that microfinance promotes entrepreneurship, boosts income-generating activity, reduces poverty, empowers the poor (particularly women in developing nations), expands access to health and education, and fosters social capital within disadvantaged and vulnerable communities (Subhabrata & Laurel, 2015).

According to Maia & Stanley (2015) due to factors such as the absence of tangible collateral, the lengthy process to initiate transactions with formal banks, which discourages those without education from approaching the banks, the lack of credit supply in rural areas due to urban biased banking networks and credit allocations, the poor typically have limited access to services from formal financial institutions in less developed countries. Independent Evaluation Group (IEG) working document published in 2015 indicated that the two crucial supply-side restraints that prevent formal banks from reaching out to the low end of demand are cost and risk. To alleviate this problem, therefore, microfinance institutions introduced joint liability lending, dynamic incentives, high repayment frequency, and focus on low-income and vulnerable societies.

Seilan (2020) elaborates on the idea of vulnerable groups by categorizing them as Self-Help Groups (SHG) which, according to his definition, are 'registered or unregistered groups of micro-entrepreneurs with similar socio-economic backgrounds, who came together voluntarily to save small amounts regularly, to mutually accept to contribute to a common fund and cater to their emergency needs on mutual help basis'. The group members, therefore, take up and manage their productive activities which could supplement their household employment through micro-credits. This helps the groups both start-up and existing enterprises, to generate income and advocate freedom and justice at the initial level. According to Balal et al. 2012 microfinance is not only focused on increasing the quality of life for the borrowers but also improving the knowledge of getting loans for poor people who need to start any business or income-generating activities.

## **1.2. Statement of the problem**

For a long time, financial institutions have been one of the major players in the economic development of countries. With the emergence of the modern economic system, these financial institutions became strong and accumulated a huge amount of capital. With this change, however, the focus of these institutions became directed at collecting savings from the poor so that they have enough money to lend to the rich (Ashenafi, 2014, Emma, 2007, NPC 2016). However, with the emergence of small businesses and individual entrepreneurs, the need for microcredit has increased enormously.

As a developing country Ethiopia has proposed micro and small enterprise development as its primary strategy of GTP II to expand employment and reduce poverty, particularly focusing on women and youths (NPC, 2016). The government of Ethiopia proposed SMEs as a means of creating employment for millions of youths and achieving sustainable development goals. Hence, there is policy support that leads small & medium enterprises (SMEs) to generate more employment compared to large firms (Ashenafi, 2014).

However, to generate more employment and impact the economy, the SMEs need to access initial as well as additional working capital. One of the means for generating the needed capital for these enterprises is access to micro-loans. With the involvement of various actors in the economy the accessibility of micro-loans for the enterprises is improving through the years. But does the access to micro-loans impact the growth of SMEs? What is the role of micro-loans in the growth of SMEs in Ethiopia?

This study, therefore, tries to study the role of micro-loans provided by microfinance institutions & saving and credit associations in the growth of small & medium enterprises. It also explains the

influence of these micro-loans in improving profitability, asset amassment, and attitude towards capital financing of SMEs.

Previous studies on this subject mainly focused on the separate measurement of SMEs' impact on society and the impact of microfinance institutions on these enterprises (Durate & Nelson 2004, Gebriela 2022). This study, therefore, combines these two major areas of study and tries to measure the role of micro-loans in the growth of SMEs.

### **1.3. Objective of the study**

#### **1.3.1. General objective**

The general objective of this study is to assess and measure the role of micro-loans in the growth of Small and Medium Enterprises (SMEs) in Addis Ababa City.

#### **1.3.2. Specific objectives**

- To measure the accessibility of micro-loans to the SMEs.
- To assess and examine the influence of micro-loans on the improvement of small and micro-enterprises.
- To check how micro-loans improve the total assets of micro & small enterprises.
- To assess the attitude change towards capital financing on businesses.

### **1.4. Research questions**

- Are micro-loans accessible for medium and small enterprises in Addis Ababa?
- How much is the influence of micro-loans on the improvement of SMEs?
- Do micro-loans improve the total assets of micro & small enterprises?
- Do micro-loans change the attitude of SMEs towards capital financing?

## **1.5. Scope of the study**

Small and medium enterprises (SMEs) in Ethiopia have been growing in number since recently. However, this study focuses only on SMEs involved in microfinance institutions and saving and credit associations located in Addis Ababa city. Addis Ababa is selected because of the large number of small businesses and individuals who are involved in microfinance activities and a huge amount of capital is associated with the enterprises. The result of this study is, therefore, applicable to the SMEs that are involved in accessing micro-loans in the mentioned city and can only be generalized in some respects.

The result of this study is limited only to the responses found from the owners of the SMEs and secondary data collected from these enterprises. The theme of the study does not include the loan status of borrowers and is only limited to the influence of micro-loans on the growth of SMEs and how it affects working capital contribution.

Although it has been more than ten years since MFIs started operating in the country, this research only covers the data of the past five years due to two reasons: 1) the number of clients in MFIs has increased significantly in these five years, and 2) the researcher's belief on the reasonableness of data for comparison.

## **1.6. Significance of the study**

Many researchers have studied the impact of micro-loans in capital generation for vulnerable groups of society like women and handicapped people. However, many of the studies in Ethiopia do not measure the impact of micro-loans on micro and small enterprises. With the increasing number of microfinance institutes in the country, the amount of loans dispersed by them is increasing rapidly which gives access to capital to micro and small enterprises and individual

entrepreneurs. Therefore, this study will give information about how micro-loans impact the capital growth of SMEs and how it helps to generate start-up capital for the enterprises.

In addition, government bodies will use the information to see the influence of micro-loans towards small & medium, enterprises in generating start-up and additional working capital and see if there are gaps to be filled by the government. Besides, the results of the study will be a foundation for other researchers who are interested in studying the impact of micro-loans in generating capital, which has not been covered by or been an interest of the study title up until now. The study will also be a good reference for academicians to indicate the relationship between micro-loans and capital generation. Other stakeholders will use the information to understand the blessings and gaps in micro-loans.

### **1.7. Limitations of the study**

This study has some limitations within which its findings need to be interpreted carefully. Some of the limitations of this study include:

- As with any other empirical research, the outcomes are limited to the data solely on evidence obtained through the scientific data collection methods.
- The study mainly focuses on the SMEs located and functional in Addis Ababa city and could not result in a generalized conclusion for the country.
- The lack of prior research about micro-loans and their impact on the growth of SMEs in Ethiopia will make citing studies about the subject matter difficult and minimal.

### **1.8. Organization of the study**

In this research paper, the researcher tries to assess the magnitude and treatment of non-performing loans in microfinance institutions. Therefore, the paper is classified into five chapters. The first

chapter focuses on the introduction part upon which a statement of the problem and objective of the study is stated. Chapter two will thoroughly analyze literature related to the topic. The third chapter of the paper deals with the methodology used by the researcher to collect data and analyze the outcomes. The fourth chapter will present the findings of the research, analysis of data collected, and interpretation of results. The last and fifth chapters will discuss the conclusion of the results and point out some recommendations by the researcher.

# **CHAPTER TWO**

## **REVIEW OF RELATED LITERATURE**

Much research has been done into micro-loans and their impact on different parts of society by different authors. Although the literature covers a wide variety of such research, this review focuses on three major themes that emerge repeatedly throughout the literature reviews. These themes are an overview of microfinance, micro-loans as a means for capital generation, and the role of micro-loans for vulnerable groups of society. Although the literature represents these themes in a variety of contexts, this paper will primarily focus on their application for micro-loans and their impact on capital generation.

### **2.1. Theoretical review**

The first microfinance institutions are believed to be created in Europe in the 16<sup>th</sup> century because of the tremendous increase in poverty. Back then the loans given were enforced by the peer groups for monitoring and the finance was initiated from donated resources (Daley, 2006). On the other hand, Afolabi et al. (2020) define microfinancing as the process of giving loans and small credits to finance small projects by either individuals or enterprises.

However, Stephen (2018) disclosed that the idea of modern microfinance emerged in the 1970s as a solution to problems faced by state-initiated credit programs. Wikipedia also affirms that the beginning of modern microfinancing was in the year 1970s when Grameen Bank of Bangladesh was founded by microfinance pioneer and Nobel Peace Prize winner Muhammed Yunus who institutionalized it in the year 1976.

In the 1980s and through the mid-1990s, micro finances expanded throughout developing countries and the ones with high development rates at the time like the Soviet Union, Vietnam, and China.

At the time though, most of the microfinance activities had been provided by NGOs rather than associations or commercial institutions (Ira, 2015). These NGOs are responsible for the dissemination of the idea of microfinance in developing countries. The early 21<sup>st</sup> century is marked by the international rise of microcredit while the G8 outlined the principles of microfinance in 2004 (BNB PARIBUS, 2004).

As per the UN report, in the mid-1990s, the thought of microfinance spread throughout Africa and became the fuel for economic growth. It also provided a more conducive environment for new entrepreneurs' development and opened up the economy significantly. According to this report, most African countries are undertaking economic reforms, including the establishment of sound macroeconomic conditions, market-based economic policies, and improvements in the business environment all of which support the growth of micro-enterprises in which clients of MFIs are involved (UN Report, 2013).

Ethiopia also followed the footsteps of other African countries and started formal microfinance activity in 1990 which was initiated by the Development Bank of Ethiopia (DBE) pilot credit scheme under the Market Towns Development project (Gebrehiwot, 1998). According to Venkata & Mangala (2013), the government of Ethiopia facilitates the licensing and supervision of institution proclamations that stimulate the spread of MFIs in both urban and rural areas. These institutions were permitted to legally accept deposits from the general public, to draw and accept drafts, and to manage funds for microfinancing businesses.

### **2.1.1. Financial Sustainability Theory**

Operations that create and preserve sustainable environmental, social, and economic settings are referred to as sustainable. Therefore, the idea of sustainability has long-term relationships with an

organization's financial success, worker health, and the number of natural resources available (Dunphy et al., 2003). A SME is considered sustainable when it adheres to these three standards. Using a variety of organizing techniques to make the greatest use of the resources at hand is necessary for economic sustainability. For long-term benefits, this is done in the most effective and ethical manner possible (Grant, 2009).

Undoubtedly, one of the most important aspects of microfinance sustainability is the financial sustainability of SMEs and organizations in other industries. Organizational sustainability is commonly defined as "financial sustainability" in microfinance because to its importance in microeconomic performance. The SME's operational sustainability and financial self-sufficiency are the two stages that can be used to quantify it. The capacity of an organization to fund all of its operations with revenue earned is known as operational sustainability (Thapa et al., 1992).

### **2.1.2. Micro-loans as a means of capital generation**

Microfinance includes the provision of financial services and the management of small sums of money through a variety of products and a network of intermediary roles targeting customers with low incomes (Aaron & Williams, 2016). The provision of loans, savings, and other essential financial services like insurance to the underprivileged is collectively referred to as microfinance.

Because the regular commercial banks' collateral requirements prevent the impoverished from obtaining certain financial services, microfinance typically offers them without these restrictions.

The additional benefit that comes from not having to put up any collateral makes poor people willing to pay for these financial services (Maisam, 2015). According to Akwasi & Gilbert (2014), MFIs contribute significantly to national economies by offering credit facilities to this market segment that the official financial sector ignores. To this idea the ILO in its 2015 publication

indicated that microcredit enables the poor in developing nations who have limited or no access to banking services to better manage their financial resources, safeguard against uncertainty, and boost their income.

Microfinance has evolved over time from just giving loans to underprivileged individuals to obtaining savings from low-income households, offering insurance, assisting with money transfers, and even promoting and dispersing clients' products (Le Thai, 2021). As stated by Paul (2014) governments in developed countries have acknowledged that Small and Medium Enterprises (SMEs), more than other businesses, need access to credit and financial services in order to expand and thrive. In this sense, the governments intend to encourage the growth of financial services by offering incentives to encourage saving, investing, and the expansion of venture capital. Farhana (2015) elaborated this idea by stating that microcredit and small savings were the main focus of microfinance institutions which gradually expanded to other services such as savings, insurance, and remittance services in response to the demand.

It is obvious that there are numerous factors that influence business growth and success, even in micro-enterprises. There is little doubt that successful entrepreneurship is a complicated phenomenon, with both internal and external influences having an impact on company performance (Kathryn & Nicholas, 1998). As claimed by Fiasorgbor & Accrachie (2014) one of the major factors influencing small and micro enterprises is the shortage of working capital. In their study, they found that about 78% of the participants faced the problem of inadequate or lack of working capital.

The pioneers of microfinance claimed that with the offering of microcredit, small-scale entrepreneurs' access to capital would be greatly increased, as would their earning potential. They also argued that microfinance would, at the very least, reduce reliance on trader-lenders skilled in

extracting surpluses by offering capital at lower interest rates than moneylenders (Robert & Jonathan, 2017). As explained by Olivia (2016) the goal of providing microloans is to reduce poverty by raising living standards on the principle that no one should be denied the opportunity to improve their life, particularly due to a lack of small initial investment money.

Accessing the necessary microfinance loans is becoming more difficult for low-income households that also want working cash for expansion. By simply giving the poor access to capital they might not otherwise be able to obtain, microfinance institutions (MFIs) assert that they enable the poor to help lift themselves out of poverty (Namara, 2013). As mentioned by Francisco et al. (2012) microfinance, or loans aimed at small-scale entrepreneurial activities of the poor who may otherwise lack access to funding, has evolved over the past several decades into a cornerstone of economic development programs. With the aim of reducing poverty and fostering development, there has been a determined attempt to extend such initiatives in recent years.

Governments, foundations, community development organizations, non-governmental organizations, and even for-profit private companies have enthusiastically embraced microfinance intervention as a solution for generating capital for small and micro-enterprises (Stephen, 2014). Maisam (2015) added that microfinance is the most crucial source for supplying loans and other essential financial services to raise employment rates, productivity, and earning potential. Additionally, it will result in people having more empowerment. Through eradicating poverty and raising standards of living, including in the areas of health, education, food, and other social aspects, microfinance has an indirect impact on vulnerable communities.

### **2.1.3. The role of micro-loans for vulnerable groups of the society**

According to Emmanuel (2020) from a business and management point of view, vulnerability is explained as:

“Vulnerability is any situation in which an individual may be unable to engage effectively in a market and, as a result, is at a particularly high risk of getting an unfavorable offer such as credit facilities with high-interest rates. There are many ways in which individuals can feel financially vulnerable; .... the two broad categories are due to the personal characteristics of the individual or due to the market structure, which affects the individual. .... Personal characteristics, such as physical disability, poor mental health, or low income are associated with consumer vulnerability.”

According to the Sustainable Development Goals (SDGs), by 2030, the population of men, women, and children of all ages living in poverty in all of its manifestations must be reduced by at least half. Additionally, it must be implemented social protection systems and policies that are suitable for all citizens at the national level, including floors. All men and women, especially the poor and the vulnerable, should have equal access to economic resources by 2030, as well as ownership and control over land and other forms of property, inheritance, natural resources, suitable new technologies, and financial services, including microfinance (Annemalla, 2022). Akwasi & Gilbert (2014) indicated that the microfinance revolution, a more recent development, assures that poor and vulnerable households, who were previously shut out of the institutional credit system, can access institutional credit, and become financially included. MFIs now provide financial services to hundreds of millions of vulnerable borrowers and are crucial to the reduction of poverty in emerging nations, particularly in Asia, Africa, and the Pacific (Le Thai, 2021).

According to Asmamaw (2014), there has recently been widespread consensus that microfinance institutions (MFIs) are effective tools to bridge the gap left by conventional banks' limits in providing financial services to the vulnerable non-poor and the poor. They are regarded as one of the most successful programs for enabling the underprivileged to participate more actively in the economy and society. Her-Loke et al, (2021) also indicated that the credit from microfinance programs also helped low-income households overcome their cash flow problems and fund investments in businesses, trades, and agriculture, boosting income and creating and improving household employment.

## **2.2. Empirical literature review**

By offering financial services to those who lack access to or are ignored by banks and other institutions, microfinance is acknowledged as an effective strategy to end poverty. The issue with the impoverished is that they are very resourceless despite having great ideas and working quite hard to overcome their poverty. These resources are being made available through microcredit, which also helps people increase their income levels (Maisam, 2015). However, improving their income level is not the only benefit for micro-loan users. There are several benefits associated with micro-loans. Among them are: the impact on education, impact on nutrition improvement, impact on beneficiaries' saving attitude, and training can be discussed briefly.

### **Impact on beneficiaries' income**

According to Dejene (2021), the capacity of a loan to occasion revenue for its recipients is one indicator of a microfinance institution's effectiveness. A better life may include an increase in income. In addition, helping low-income households generate income and reducing poverty are two other main goals of microfinance. It is also believed that one of the immediate impacts of

having access to credit is improving income for households and enterprises which also may impact other economic conditions. In a study conducted by Birhanu (2013) to study the relationship between income and micro-loans 97% of respondents reported their overall level of income being increased significantly compared to the non-credit users whom only 20% reported an increase in their income.

### **Impact on education**

The degree of investment in children's education is generally accepted to be the outcome of a variety of supply factors and a particular household's demand for education, despite the fact that impacts may appear to be numerous and their interactions to be complicated (Nathalie, 2018). In one way or another, beneficiaries of micro-loans are thought to advance children's educational levels. A study conducted by Dejene (2021) found that once the beneficiaries enrolled in these institutions, the number of children attending school increased. Of the respondents, 69% said that they were able to educate their children better after receiving the loan than before.

This is why in many nations; microfinance is utilized to promote financial independence and enhance the lives of disadvantaged young people through education. Lack of funding is a problem for many poor families running micro businesses throughout the world (Johnston and Morduch Citation2008). Boudour (2019) stated that microcredit gives the underprivileged easier access to healthcare and educational opportunities. Having a reliable and profitable source of income enables the underprivileged to pay for their children's education and access public healthcare.

### **Impact on nutrition improvement**

Having access to microcredit enables the poor to earn more money, which allows them to save money to raise their security levels and spend more on food and nutritional necessities (Boudour,

2019). Mknelly and Dunford's (1999) research demonstrates that signing up for a microcredit program boosted food spending, which suggests that household nutrition has improved. According to the findings of Dejene (2021), the respondents were asked to reflect on their replies about the improvement of food, such as increasing food consumption in terms of quantity and diversity. Depending on how well the beneficiaries perform in the program, access to microfinance resulted in an improvement in the nutritional intake of the beneficiaries and their families. It is also implicated in a study conducted by Ayalew (2014) the beneficiaries' nutritional trends improved by consuming a variety of foods as a result of increases in business profit and high income from the sales of coffee and chat.

### **Impact on beneficiaries' saving attitude**

By assisting people in obtaining loans and fostering the habit of saving, microfinance organizations broaden the opportunities available to the less fortunate members of every society. Thus, the creation of these organizations has been viewed as a remedy for low domestic savings by giving access to financial services to rural poor households (Solomon & Tsegaw, 2016). As per Dejene (2021) since saving is a prerequisite to access credits in MFIs and saving & credit associations, beneficiaries tend to develop a saving culture without even noticing it. It is also stated by the Asian Development Bank (ADB) (2007) study results that the saving and expanding culture which was predominantly occupied by men before the introduction of microfinance institutions has been changed. Women who have never saved money or been involved in decision-making in the family's business decisions became involved and empowered.

On the other hand, Martha (2014) viewed the saving habit in two different ways: voluntary and mandatory. As per the result of her study although voluntary saving habits have shown no

improvement in the beginning of the formation of the microfinance institutions, through time slight breakthrough has resulted. However, mandatory savings have registered high levels of increase.

### **Training**

Many MFIs offer socially oriented services in addition to financial intermediation, such as group formation, confidence building, training in financial literacy, and management skills for group members. Credit risk can be decreased by properly informing clients about the process and providing them with ongoing training on credit management. In a study conducted by Tamirat (2017), it is stated that out of the 155 respondents 70.1% were trained on loan utilization and business aspects, policies, and procedures of the MFIs.

Moreover, according to Uppsala University's working paper published in 2010, the fact that participation in MFIs alone "trains" individuals in a variety of ways is one justification for their emphasis on lending. Members first embrace a disciplinary ethic through work, saving, and repayment. Second, participants "learn by doing" without any formal training because they are actively working on projects. Thirdly, regular gatherings give participants a forum for talking about and learning from one another's work-related issues.

#### **2.2.1. The relationship between micro-loans and small and medium enterprises (SMEs)**

In emerging nations, when the poor cannot afford to put up collateral for conventional financial services and transaction costs are too high, a lack of access to credit is commonly acknowledged as the primary factor contributing to poverty. The inability of the poor to get financial access brings light to the idea of financial inclusion which is the method of offering banking and financial services and solutions to every individual in society without any form of discrimination (Danam

& Sunder, 2022). As stated by Idowu (2010) the lack of both loan and equity finance is a significant obstacle to the SME sector's rapid development. It has been determined that gaining access to capital is essential for SMEs to succeed in their efforts to increase their level of productivity, compete, generate employment, and fight poverty in emerging nations. Small businesses, particularly those in Africa, frequently struggle to meet the requirements imposed by financial institutions, which view SMEs as a risk due to the absence of adequate guarantees and knowledge regarding their capacity to repay loans. Without financing, SMEs cannot develop to compete in international markets, acquire new technologies, or even establish commercial relationships with larger companies.

### **Why micro-credit**

One of the major problems encountered by small businesses and entrepreneurs in many parts of the world is the ability to generate initial capital for their investment. In many cases, it is difficult for these individuals or businesses to fulfill the requirements by regular commercial banks to be eligible for credits. Due to that many were forced to keep their ideas to themselves or see others do it in a wrong way. Entrepreneurs with little wealth, many of whom are women and fresh for business, frequently lack the start-up capital required to start a business, adequate credit for securing low-interest rate loans, or the institutional knowledge to access available resources (Wells Fargo, 2020)

Micro-credit, therefore, plays a major role in not only filling the gap of conventional banks' limitations in reaching the poor and vulnerable but also is an effective intervention for empowering the poor in their economic and social encounters (Asmamaw, 2014). Numerous researchers and policymakers contend that microfinance promotes entrepreneurship, boosts income-generating activity, reduces poverty, empowers the poor (particularly women in developing nations), expands

access to health and education, and fosters social capital within disadvantaged and vulnerable communities (Subhabrata & Laurel, 2015).

### **Factors affecting SMEs from access to credit:**

Start-up business: Most business owners struggle with how to secure funding, especially at the buildup of the business. Some MFIs evaluate the pros and downsides of taking into account established business owners against new entrepreneurs. Companies that get initial funds from MFIs from the ground up are thought to have an impact on society by reducing poverty and raising income levels. However, due to the lack of adequate collateral and reputation access to credit will not be easy for start-up businesses.

Stability: The other factor hindering credit access for SMEs is the stability of the businesses. According to Tassew (2018), the survival rate for SMEs in Ethiopia is about 68% leaving the rest to quiet their business between two to five years. This failure rate impacted the regular banks' trust to invest and give out credit to the SMEs.

### **2.3. Research Gap**

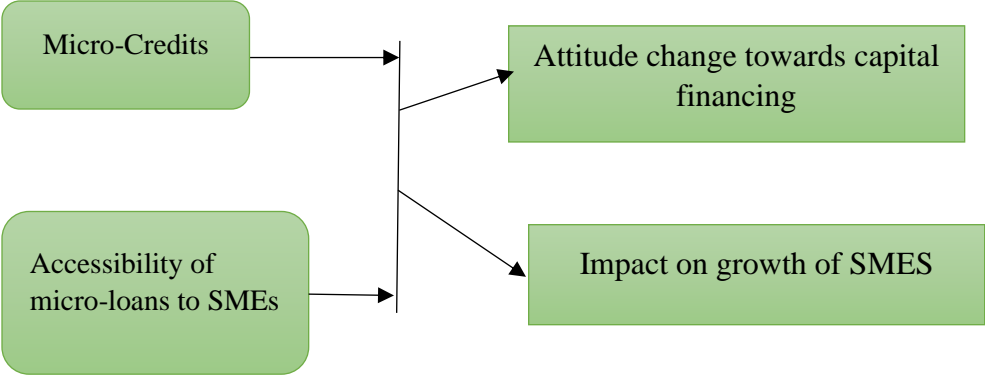
The literature reviews discussed so far indicated that micro-credits have been playing a major role in the improvement of small and medium enterprises, individual entrepreneurs, and venerable groups of the society. The impacts of the micro-loans have been analyzed through income generation, education for those groups, nutritional improvements, saving attitude, and trainings. Moreover, the discussions above have seen the relationship between microfinance institutions and small and medium enterprises, how micro-loans became a means of capital generation, and overview of microfinance institutions.

However, to the knowledge gap of the researcher, there appears to be no study which directly show the impact of micro-loans in small and medium enterprises in Ethiopia. Therefore, by considering the above knowledge gap, the study examines the role of micro-loans in the growth of SMEs in Addis Ababa city.

### 2.4. Conceptual framework

In order to assess the role of micro-loans in the growth of small and medium enterprises and explain the specific objectives clearly the following conceptual framework is used. This conceptual framework takes in account assumption that the effect of micro-credit on SMEs can be measured through accessibility, improvements in income and profit, net asset improvement, and attitudinal change towards financing the businesses.

Figure 2.1. Conceptual framework of the study



Source: Own survey

# **CHAPTER THREE**

## **RESEARCH DESIGN AND METHODOLOGY**

This study is focused on the role of micro-loans in capital generation for society. The research aims to show how much micro-loans from microfinance institutions contribute to capital generation for small and micro enterprises and individual entrepreneurs. It also shows why small and micro enterprises are unable to use regular commercial banks for their credit needs and how microfinance institutions extend their hand in helping the vulnerable group of society to improve their capital need. Therefore, this chapter is designed to detail the research approach used, the research design selected, the population and sample size determined, sampling procedures, the types, and sources of data, and how and why the methodology is preferred.

### **3.1. Research design**

This research uses a descriptive study approach to indicate the role of micro-loans in the growth of small and medium enterprises, why micro-loans are not accessible in regular commercial banks, and how the vulnerable group of society became beneficiaries of micro-loans from microfinance institutions.

The data collection in this study is formulated in order to demonstrate the ratio of capital generated from micro-loans in society, how it affects the capital structure of the borrowers, and how it is implicated in their books of records. Moreover, the data collected is cross-sectional rather than longitudinal survey.

### **3.2. Research approach**

This study aims to critically assess the role of micro-loans in capital generation for the society in Ethiopia and report the findings. With this in mind, the research follows the analytical approach

which is based on the outcome of this study. Moreover, the data collection for the research is based on the process of the research, and it will be quantitative.

The analytical part of the research not only describe the characteristics of the population or phenomenon studied but also focus on why a particular phenomenon will occur. It is a way to find a solution to any problem on a scientific basis.

The quantitative research approach is concerned with issues that can be measured in amount or numerical terms. It emphasizes objective measurements and the statistical, mathematical, or numerical analysis of data collected through polls, questionnaires, and surveys, or by manipulating pre-existing statistical data usage computational techniques (Oberiri, 2017)

In this study the researcher tries to determine the role of microloans in the growth of small and medium enterprises (SMEs), he believes that the quantitative research approach is ideal since most of the data to be collected are quantifiable and can be expressed in statistical measurements.

### **3.3. Population, sample size, and sampling**

#### **3.3.1. Study population**

According to Ranjit (2011), the class, families living in the city or electorates from which you select your sample are called the population or study population. Considering this, the target population for this study is all members of MFIs in Addis Ababa city who once or multiple times get access to micro-loans. There are more than 11 microfinance institutions registered by NBE that are actively working in the city. Therefore, the research tries to include borrowers from all the institutions in the population.

### **3.3.2. Sample size**

As stated by Mark et al. (2009), sample size is determined by what we need to learn, what will be useful, what will be credible, and what we can accomplish with the tools at our disposal. He also added that when doing quantitative research, a researcher should be more worried about the validity of data and the understanding we gain than the sample size. However, when you select a sample in quantitative studies you are primarily aiming to achieve maximum precision in your estimates within a given sample size and avoid bias in the selection of your sample (Ranjit, 2011).

According to a report by AllAfrica (2022) there are more than 5.5 million active borrowers in microfinance institutions in Ethiopia in the year 2022. As per the National Bank of Ethiopia report, there are around 115,000 SMEs active in the country of which nearly 2,000 are found in Addis Ababa City. Considering this it can be easily estimated that the population size for this study is high. However, with the available resources the researcher decides to make the sample size to at least 10% which is considered acceptable by many scholars (Piroska, 2021). Therefore, with a random sampling method with a 95% confidence interval and 5% margin of error the sample size the researcher believes to represent the result is 200 SMEs.

The decision on population size is also influenced by two major reasons: 1) most SMEs are not willing to share their financial data with anyone, and 2) of the 2,000 SMEs in the city not all have membership with MFIs and credit and saving associations.

### **3.3.3. Sampling procedures**

For this research convenience sampling procedures has been applied. The reason behind selecting this procedure is: first information about the SMEs should be collected from microfinance

institutions (MFIs) and saving and credit associations followed by contacting the SMEs' willingness to participate in the study through the management of the MFIs. After the first round of selection is done the SMEs should be identified by the number of years of membership with the institutions and their credit relation.

### **3.4. Data collection methods and procedures**

The primary data is collected through questionnaires in such a way that it can be quantified and measured. The questionnaire is designed in a structured manner using ordinal scale trying to touch every variable under study. The question is outlined to include the opinions of the participants under study.

The administration of the questionnaires is handled in two different ways. The first is for respondents who are willing to discuss the questions with the researcher and answer them, the researcher will take time and collect the answers right away. The second is the drop-and-pick method for respondents who want to take time and answers. Since the time required to fill out the questionnaire is between 30 to 40 minutes, the later respondents are required to return the answers within two days of receiving them.

### **3.5. Types and sources of data**

The data for this study is gathered from both primary and secondary sources. The primary data has been collected from questionnaires distributed to the owners or the SMEs. The secondary data for this research is found in the financial statements of the companies that show historical data about performance improvement.

### **3.6. Data analysis and presentation**

The data collected has been sorted according to the different categories. Before processing the responses, the completed questionnaires have been edited for completeness and consistency. Then the raw data has been coded for analysis using Statistical Package for Social Sciences (SPSS). An analytical approach is used to explain the analyzed data and all quantitative data has been presented using frequency distribution tables, graphs, and figures as appropriate.

### **3.7. Ethical considerations**

The focus of this study is to assess the impact of micro-loans for capital generation in Ethiopia, Addis Ababa city as a representation. The researcher uses all the guides of ethical consideration for this study as stated below:

- All research respondents will participate voluntarily in the study and ask for their consent before approaching them.
- All the questions will disregard offensive, discriminatory, or unacceptable use of language and the privacy of the respondents will be kept.
- The research maintains a high level of objectivity in discussions and analysis.
- All authors used as references will be stated and acknowledged by the researcher.

# CHAPTER FOUR

## RESULTS AND DISCUSSION

In this chapter, the results of the data analysis are presented. The data were collected and then processed in response to the problems posed in chapter one of this thesis.

### 4.1. Response Rate of the Quantitative Data

In this study, a total of 200 respondents were selected and invited to complete the questionnaires and present their financial statements. And 181 of them were properly completed and submitted usable questions, thereby generating a return rate of 90.5%.

### 4.2. Description of the Study Participants

Analyzing the background characteristics of the respondents is important to understand some background information about the sample population who participated in the study. Accordingly, respondents' sex, age, educational status, and number of years in operation in the enterprise have been analyzed and presented in Tables 4.1 and 4.2.

Table 1 Sex and Age of Sample Sampled Respondents

|                           |          | Count | Column N % |
|---------------------------|----------|-------|------------|
| Gender of the respondents | Female   | 78    | 43.1%      |
|                           | Male     | 103   | 56.9%      |
| Age of the respondent     | 20 - 30  | 96    | 53.04%     |
|                           | 30 - 40  | 60    | 33.15%     |
|                           | 40 – 50  | 17    | 9.39%      |
|                           | Above 50 | 8     | 4.42%      |

Source: Own survey, 2023

As the result in Table 4.1 presents, the majority (56.9%) of small and micro-enterprise owners were males, while females accounted for 43.1%. Although there is an increase in the participation of females in ownership of SMEs it is still low compared to male counterparts. Regarding the age distribution of sample respondents, the analysis result shows that the majority. (53.04%) of respondents are in the age range of 20-30. In the same manner, about 33.15% of them lie in the age group of 30 – 40 while 9.389% are between 40 -50. The rest 4.42% of them are above the age of 50.

Since more than 86% of the respondents are between 20 – 40, which implies that the majority of owners of SMEs are considered to be young and productive which shows that there is a good chance for growth for the enterprise.

Table 2 Educational status and number of years in operation

|                                     |                       | Count | Column N<br>% |
|-------------------------------------|-----------------------|-------|---------------|
| Educational level of the respondent | Secondary school      | 37    | 20.44%        |
|                                     | Certificate           | 31    | 17.13%        |
|                                     | Diploma               | 14    | 7.73%         |
|                                     | First Degree          | 88    | 48.62%        |
|                                     | Second Degree         | 11    | 6.08%         |
| Experience in the business          | Less than 5 years     | 29    | 16.02%        |
|                                     | Between 5 to 10 years | 114   | 62.98%        |
|                                     | Above 10 years        | 38    | 21.0%         |

Source: Own survey, 2023

As Table 4.2 presents, the majority (48.62%) of respondents in the study area have at least a first degree in different educational disciplines. Similarly, about 20.44% of them completed secondary

school and 17.13% are certificate holders in various fields. Likewise, 7.73% of them are diploma holders while the least (6.08%) have a second degree. Hence, from the educational levels mentioned above, it is possible to say that large proportions of the participants in small and micro enterprises at least completed secondary, possess certificates, or have a first degree.

Unlike previous studies which resulted in a lower number of people participating in small and medium enterprises with college diplomas or degrees, this study shows that education plays a major role in owning and managing SMEs. The assumption for this major attitude change might come from the ever-growing unemployment rate in graduates and access to education. However, it should also be noted that the study area also has a major impact on the demography of the respondents.

In connection to respondents' duration in the enterprise, the majority (62.98%) of respondents have owned their enterprises between 5 - 10 years. On the other hand, 21% of the respondents worked more than 10 years while 29 respondents (16.02%) have experience of less than five years. As most of the respondents are young it is not unexpected to see many of them have less than 10 years' experience in the business.

### **4.3. Characteristics of enterprises**

In this section, the survey tries to identify the characteristics of the micro and small enterprises under review. The characteristics that have been identified and analyzed are the form of business, types of business, and the growth pattern of the businesses.

### 4.3.1. Form of business

Table 3 Form of business

|                     |                     | Count | Column N % |
|---------------------|---------------------|-------|------------|
| Form of Enterprises | Sole proprietorship | 95    | 61.33%     |
|                     | Partnership         | 57    | 31.49%     |
|                     | Share Company       | 0     | 0.0%       |
|                     | Cooperative         | 13    | 7.18%      |

Source: Own survey, 2023

Table 4.4 shows that more than half of the businesses are sole proprietors with 61.33% followed by partnership with 31.49%. From the enterprises under review, there are no registered share companies while only 13 cooperatives with less than 8% of the total. The result has shown that more than 90% of SMEs are either sole proprietorships or partnerships which is because of the easiness of formation, less complication for management, and less capital requirement compared to share companies and cooperatives.

### 4.3.2. Types of business

Table 4 Types of business

|                  |                | Count | Column N % |
|------------------|----------------|-------|------------|
| Type of business | Manufacturing  | 54    | 29.83%     |
|                  | Service giving | 78    | 43.1%      |
|                  | Retail         | 43    | 23.76%     |
|                  | Construction   | 6     | 3.31%      |

Source: Own survey, 2023

The types of business as displaced by table 4.5, the majority of SMEs (43.1%) are involved in the service sector while 29.83% are manufacturing. There are also retail businesses with 23.76% and

construction 3.31% with only six enterprises. The reason behind this result is that unlike construction, manufacturing, and retail businesses, the service-giving sector needs less intense capital requirements. The other reason is inadequate infrastructure and land policy in the city, taking manufacturing as an example.

### 4.3.3. Growth Index

Table 5 Growth dimension pattern

|                                |         | Count | Column N % |
|--------------------------------|---------|-------|------------|
| Growth index of the enterprise | Incline | 174   | 96.13%     |
|                                | Decline | 7     | 3.87%      |

Source: Own survey, 2023

Table 4.6 indicates that a very high percentage of the respondents (96.13%) agreed that they have shown growth in the past five years whereas 3.87% answered otherwise. Most of the businesses which showed a decline are either in construction or manufacturing.

## 4.4. Descriptive Analysis

Under this sub-topic, data that were collected using both multiple choice questions and Likert Scale questions are summarized and analyzed. The independent variables studied in this section are membership status with microfinance and saving and credit institutions, accessibility of loans for SMEs, and the influence of micro-loans on the improvement of small and micro-enterprises.

Respondents were required to indicate their level of agreement on the five scales for the Likert Scale questions. Accordingly, Al-Sayaad, Rabea, and Samrah (2006) proposed techniques of mean score range in Table 4.3 and the descriptive analysis is summarized accordingly.

Table 6 Mean Score Range for Five Scale Liker's Response

| Mean                        | Response          |
|-----------------------------|-------------------|
| From 1.00 to less than 1.80 | Strongly disagree |
| From 1.80 to less than 2.60 | Disagree          |
| From 2.60 to less than 3.40 | Neutral           |
| From 3.40 to less than 4.20 | Agree             |
| From 4.20 to less than 5.00 | Strongly Agree    |

Source: Al-Sayaad et al. (2006)

#### **4.4.1. Accessibility of micro-loans for SMEs**

In this section, the SMEs' membership status with the microfinance institutions and credit and saving associations and accessibility of loans from these institutions is summarized and analyzed.

The table below shows the results of the study.

Table 7 Membership status with microfinance and saving and credit institutions.

|                                       |                       | Count | Column N % |
|---------------------------------------|-----------------------|-------|------------|
| Years of membership in MFI            | Less than 1 year      | 0     | 0.0%       |
|                                       | Between 1 to 5 years  | 21    | 11.6%      |
|                                       | Between 5 to 10 years | 102   | 56.35%     |
|                                       | Above 10 years        | 58    | 32.05%     |
| Waiting period to access loan service | Less than 6 months    | 0     | 0.0%       |
|                                       | 6 months to 1 year    | 123   | 67.95%     |
|                                       | Between 1 to 3 years  | 58    | 32.05%     |
|                                       | Between 3 to 5 years  | 0     | 0.0%       |
|                                       | More than 5 years     | 0     | 0.0%       |

Source: Own survey, 2023

As per the results tabulated above more than half of the SMEs (56.35%) who participated in this study have between 5 to 10 years of membership followed by 32.05% with above 10 years of experience with MFIs and/or credit and saving associations. The rest 11.6% have membership experience between 1 to 5 years. Since this study tried to study major changes over 5 years time, the results are believed to be sound because 88.4% of the participants' data qualify for the least requirement.

The other major part to be studied in this research is the waiting period to access loans from the institutions. As per the results in Table 4.8, 67.95% of the respondents only waited between 6 months and one year time to access a loan while the rest 32.05% waited between 1 to 3 years. It can be clearly seen that the waiting time to access a loan is very little compared to the accessibility

of loans within regular banks or the SMEs' experience of accessing loans in regular banks was almost zero according to their responses stated in the tables below.

Table 8 Request loan from banks

|                    | Frequency | Percent | Valid Percent | Cumulative Percent |
|--------------------|-----------|---------|---------------|--------------------|
| Valid "Yes, I did" | 147       | 81.2    | 81.2          | 81.2               |
| "No, I did not"    | 34        | 18.8    | 18.8          | 100.0              |
| Total              | 181       | 100.0   | 100.0         |                    |

Source: Own survey, 2023

Table 9 Bank response to loan request

|                                   | Frequency | Percent | Valid Percent | Cumulative Percent |
|-----------------------------------|-----------|---------|---------------|--------------------|
| Valid The loan request was denied | 147       | 81.2    | 100.0         | 100.0              |
| Missing System                    | 34        | 18.8    |               |                    |
| Total                             | 181       | 100.0   |               |                    |

Source: Own survey, 2023

As stated in Table 4.9 81.2% of the respondents have applied for bank loans at least once while the remaining 18.8% never contacted regular banks for loan requests. However, as shown in Table 4.10 all the SMEs (100%) who had applied for loans in regular banks didn't get access to any type of loan although they were customers of the banks for a long time. Taking this into account the participants believe that the waiting time to access loans in MFIs and credit and saving associations is very little.

#### 4.4.2. The reasons behind the inaccessibility of loans in regular banks

As shown in the results above all of the SMEs that approached regular banks to access loans have been denied. However, the researchers have tried to understand the reasons why these banks do not give positive responses to the SMEs. Table 4.11 below shows some of the reasons listed with the respondents' attitudes towards them.

Table 10 Reason behind the inaccessibility of loans

|                        |   | Responses |         | Percent of Cases |
|------------------------|---|-----------|---------|------------------|
|                        |   | N         | Percent |                  |
| Reason Denied<br>Loans | Couldn't present enough collateral              | 133       | 90.5%   | 90.5%            |
|                        | Not being able to complete loan formalities     | 147       | 100%    | 100.0%           |
|                        | The banks were not willing to handle microloans | 147       | 100%    | 100.0%           |

Source: Own survey, 2023

The first reason for the denial of loans in regular banks is associated with the presence of collaterals. This issue is not only concerned with the presence but also the type of collateral presented to the banks. Most banks, until recently, didn't accept movable properties for loan guarantee. Moreover, the lone guarantee they needed was way beyond the amount of the loan request. Due to these and other reasons 90.5% of the SMEs responded that one of the reasons for inaccessibility of loans was presenting enough collateral.

The other reason is the required formalities needed by the banks to access loans. In our country's case, most of the SMEs didn't have compiled financial data that can be verified for trustworthiness. Before being an enterprise many of these businesses were owned and operated by individual entrepreneurs without any license or registration. Therefore, the SMEs were not able to fulfill the least requirement by the banks. As per their response, 100% of the participants believe that their loan was denied because they couldn't satisfy the required formalities.

The other reason that all 100% of participants agreed upon is the banks' willingness to handle micro-loans. Without exaggeration, all banks in Ethiopia focus on collecting savings from small households and lending them to bigger businesses. This is due to many reasons including minimizing risk, reducing handling costs, and easiness of management. Hence, SMEs are not welcomed in the regular banks.

#### **4.4.3. Sources of capital for the SMEs**

Although many of the SMEs use different sources of capital for their business this study wishes to see the impact of micro-loans on alternative capital. In the table below micro-loans are an alternative to the source of capital and how much the membership in the institutions opens capital options.

Table 11 Capital source & generation options

|   |                                     | Count | Column N<br>% |
|---|-------------------------------------|-------|---------------|
| Another source of additional working capital      | Yes                                 | 0     | 0.0%          |
|   | No                                  | 139   | 76.8%         |
|   | Partially                           | 42    | 23.2%         |
| Capital generation option you get from membership | I found it excellent                | 162   | 89.5%         |
|   | It is a very good option            | 19    | 10.5%         |
|   | It is fair                          | 0     | 0.0%          |
|   | It doesn't give me that much option | 0     | 0.0%          |
|   |                                     |       |               |

Source: Own survey, 2023

As stated in table 4.12 majority of the respondents 76.8% had no other option for additional working capital if they haven't had loan access in the institutions. Meanwhile, the other 23.2% responded that they partially have other capital options from friends or family. In the response from SMEs on how they find the capital generation options from membership in the institutions, 89.5% say that they found it an excellent option whereas the remaining 10.5% say it is a very good option. The results indicate that MFIs and credit and saving associates were almost the only options to get additional working capital. At the end of the questionnaire there is a personal opinion question regarding whether the SMEs have better alternative sources of capital other than the micro-loans and the answer for that by all participants was 'no better alternative'.

#### 4.4.4. The impact of micro-loans on income and capital of SMEs

In this part, respondents have given different outcomes assumed to have an impact on income and capital and they evaluated their answers using the Likert scale model. The results are summarized in the table below.

Table 12: Impact on income and capital

|  | N   | Minimum | Maximum | Mean | Std. Deviation |
|--|-----|---------|---------|------|----------------|
| My total income increase                       | 181 | 3       | 5       | 4.01 | .503           |
| My profit has increased                        | 181 | 3       | 5       | 3.97 | .604           |
| Easily meet my working capital need            | 181 | 4       | 5       | 4.77 | .501           |
| My working capital has increased               | 181 | 4       | 5       | 4.53 | .516           |
| Start a new business or improve the one I have | 181 | 3       | 5       | 4.50 | .533           |
| Change my business idea into reality           | 181 | 3       | 5       | 3.97 | .397           |
| Learned how to use money responsibly           | 181 | 4       | 5       | 4.63 | .447           |
| Overall mean                                   |     |         |         | 4.34 |                |
| Valid N (listwise)                             | 181 |         |         |      |                |

Source: Own survey, 2023

The findings in Table 4.12 above show that the respondents agreed that their total income has increased (mean = 4.01). Moreover, the increase in profit has been agreed with (mean = 3.97) and the institutions have been given an option to easily meet working capital needs was also strongly

agreed with (mean = 4.77). Whereas they strongly agreed that their working capital has been increased by being a member of these institutions (mean = 4.53).

On the other hand, they agreed that the micro-loans from these institutions help them to start a new business or improve the one they have (mean = 4.5), and they also agreed that it helped them to change their business idea into reality (mean = 3.97). The other impact strongly agreed upon by the respondents is membership in these institutions teaches them how to use money responsibly (mean = 4.63). All the responses on the impact on income and capital either agreed or strongly agreed by the respondents with an overall mean of 4.34 showing that MFIs and credit and saving associations have a positive impact on the SMEs.

#### **4.4.5. Benefits associated with membership in the institutions**

In addition to the impact of micro-loans on SMEs, this study has also measured the benefits associated with membership in MFIs or credit and saving associations. Some ideas believed to be benefits of membership in the institutions have been listed and the respondents evaluated them using the Likert scale. The table below lists the results analyzed from the Likert scale questions.

Table 13 Benefits associated with membership with the institutions

|  | N   | Minimum | Maximum | Mean | Std. Deviation |
|--|-----|---------|---------|------|----------------|
| I easily became illegible for loan           | 181 | 3       | 5       | 4.27 | .661           |
| Better interest rate and repayment schedules | 181 | 2       | 5       | 3.51 | .647           |
| Helped me to improve my book of records      | 181 | 4       | 5       | 4.46 | .314           |

|  |     |   |   |      |      |
|--|-----|---|---|------|------|
| Easily get services that I couldn't get in regular banks   | 181 | 3 | 5 | 4.76 | .432 |
| Helped me to improve my economic benefit to a great extent | 181 | 3 | 5 | 4.01 | .670 |
| It helped me to improve my saving habits                   | 181 | 4 | 5 | 4.61 | .501 |
| Helped me to become an entrepreneur & employer             | 181 | 3 | 5 | 4.11 | .499 |
| Overall Mean   |     |   |   | 4.25 |      |
| Valid N (listwise)   | 181 |   |   |      |      |

Source: Own survey, 2023

The findings listed in the table above showed that the respondents agreed on most of the benefits associated with membership except for a few. One of the benefits that the respondents strongly agreed upon is the easiness of eligibility for loans with a mean value of 4.27 followed by ‘it helped me to improve my saving habits’ with the same mean value of 4.61. It is also strongly agreed that membership helped to easily get services that couldn't be possible in regular banks with a mean of 4.76 and improve recording keeping with a mean of 4.46.

The other benefits agreed by the respondents include better interest rates and repayment schedules (Mean = 3.51) and the economic benefits of owners have improved (Mean = 4.01). The overall results of the above table (Overall Mean = 4.25) indicate that membership in the institutions has benefited the SMEs in various ways.

#### 4.4.6. Impact on capital

To measure the impact of micro-loans on the capital of the SMEs the study analyzes two different sets of data. The first measures whether or not micro-loans improved the capital capacity of the SMEs. The result is shown in the table below.

Table 14 Capital improvement after availing of micro-loan

|             | Frequency | Percent | Valid Percent | Cumulative Percent |
|-------------|-----------|---------|---------------|--------------------|
| Valid Yes   | 167       | 92.3    | 92.3          | 95.3               |
| I can't say | 14        | 7.7     | 7.7           | 100.0              |
| Total       | 181       | 100.0   | 100.0         |                    |

Source: Own survey, 2023

As seen in the table 92.3% of the respondents agreed that the availability of micro-loans has improved their capital while the rest 7.7% responded “I can’t say”. No respondent answered “No” for this question implying that the micro-loans have improved the capital of the SMEs.

The second and last topic covered in this part is the measure of respondents' opinions on whether or not their company’s capital structure changed. The results are summarized in the table below.

Table 15 Is your capital structure changed

|             | Frequency | Percent | Valid Percent | Cumulative Percent |
|-------------|-----------|---------|---------------|--------------------|
| Valid Yes   | 144       | 79.6    | 79.6          | 79.6               |
| I can't say | 37        | 20.4    | 20.4          | 100.0              |
| Total       | 181       | 100.0   | 100.0         |                    |

Source: Own survey, 2023

According to the results in the table above 79.6% of the respondents agreed that due to the micro-loans from the institutions their capital structure has been changed. The rest 20.4% presume that they can't give their opinion on the issue.

#### 4.4.7. The impact of micro-loans on asset improvement of SMEs

The first two objectives of this study 1) measuring the accessibility of micro-loans to SMEs and 2) assessing and examining the influence of micro-loans on the improvement of small and micro-enterprises have been analyzed in the reviews above. The third objective of checking how micro-loans improve the total assets of micro & small enterprises will be presented in the table below.

Table 16 Total asset improvement in percentage

|   | N   | Minimum | Maximum | Mean  | Std. Deviation |
|---|-----|---------|---------|-------|----------------|
| Total asset improvement within five years in percentage | 175 | 19      | 179     | 75.33 | 33.353         |
| Valid N (listwise)                                      | 175 |         |         |       |                |

Source: Own survey, 2023

As indicated in Table 4.16 the minimum total asset improvement within five years covered under study is 19% while the maximum is 179%. The mean value of the improvement is 75.33 showing that the total assets of the SMEs have primarily shown improvement. From the participants of this study, 6 businesses were not willing to show their financial statements and about 29 respondents have less than five years of financial statements to present. However, the researcher has used the available data and showed the results as described above.

#### 4.4.8. Debt to Equity Ratio

The last objective of this study is to assess the attitude change towards capital financing on businesses. Capital financing means how much of the total capital of the business is financed by debt and equity respectively. Therefore, the study has measured the capital mix of the SMEs for the first and the last year of the covered in the research. For convenience purposes, however, instead of listing each SME's ratio the researcher has summarized the total values in the table below.

Table 17 Summary of Debt-to-Equity ratio (D/E)

|        | Total Debt in<br>'000 | Total Capital<br>in '000 | Debt to<br>Equity<br>Ratio |
|--------|-----------------------|--------------------------|----------------------------|
| Year 1 | 23,500                | 37,600                   | 0.62                       |
| Year 5 | 41,220                | 40,650                   | 1.01                       |

Source: Own survey, 2023

The summary in Table 4.17 showed that at the beginning of the study year (Year 1), the total capital of the SMEs was much higher than the total debt making the ratio 62:100. On the other hand, the final year of the study (Year 5) reveal that the total amount of loan used by the SMEs to support their business is higher than their own capital making the ratio 101:100. This change in capital structure of the businesses indicate that the impact of micro-loans as an option to improve working capital of SMEs is clear and change in the ratios from year 1 to 5 implies the improving consciousness of the organizations to use micro-loans as a capital raising instruments.

# **CHAPTER FIVE**

## **SUMMARY, CONCLUSION, AND RECOMMENDATIONS**

An overview of the entire investigation is provided in this chapter of the thesis. The chapter recapitulates the study's summary, key findings, conclusions, and recommendations. In this chapter, there are four main sections. The study's executive summary is presented in the first section. The research's major findings are covered in the second portion, and the study's conclusions and recommendations will be highlighted in the third and fourth sections.

### **5.1. Summary**

Small and medium enterprises (SMEs) are known to be the major players in the development of nations and contribute a lot to alleviating or reducing unemployment levels in many countries worldwide. However, their improvement journey was not easy due to several reasons. One of the major problems encountered by small businesses and entrepreneurs in many parts of the world is the ability to generate initial capital for their investment. Even though there are many regular financial institutions like banks in many developing countries due to the gap between demand and supply, costs associated with lending, and risk factors they prefer to collect savings from the poor and lend them to the bigger investors which makes loan accessibility to SMEs very low or null.

The need to fill this gap, therefore, became a reason for the emergence of micro-finance institutions that provide micro-loans for individual entrepreneurs or SMEs. The idea behind micro-loans is to create an opportunity for businesses and individuals neglected by regular banks to fulfill their working capital needs. Previous studies on this subject mainly focused on the separate measurement of SMEs' impact on society and the impact of microfinance institutions on these enterprises. With the growth of SMEs and the need for micro-loans in Ethiopia, this study wants

to measure the role of micro-loans towards the improvement of SMEs' assets, capital, and saving habits, and the results have been presented.

Chapter four of the study presented a careful discussion and analysis of the results of the study. The study generally includes the opinion of owners of SMEs towards the impact of micro-loans on their business and personal lives. Moreover, the financial statements of the SMEs have been reviewed to assess the effect of the micro-loans on asset improvement and capital structure changes.

As per the results of this study from the 181 SMEs participated 61.33% are sole proprietorship, 31.49% are partnership, and the rest 7.18% are cooperatives. Most of these businesses are engaged in the service industry with 43.1% followed by manufacturing 29.83%. Although 81.2% of the enterprises knocked on the door of regular banks requesting loans at least once in their existence all have been denied or didn't get a positive response. The reasons for the denial of loans include insufficient collateral (90.5%), unwillingness of the banks to entertain micro-loans (100%), and not able to complete loan formalities (100%).

Regarding membership in the microfinance institutions most of the respondents have above 5 years of membership with 88.4% while the rest 11.6% fall in between 1 to 5 years. After membership, however, for the 67.95%, it only takes six months to a year to access a loan. The rest 32.05% say that they had to wait from 1 to 3 years to access loans. Comparing this to their request in regular banks the respondents agreed that micro-loans played a major role in addressing additional working capital needs. To support this opinion, 76.8% of the respondents said that they had no other option to get additional working capital while the rest 23.2% said only partially. In respect of this 89.5% of the participants see micro-loans as an excellent option for capital needs and 10.5% say it is a very good option.

The other issue covered in this study is to assess the impact of micro-loans on the income and capital of the SMEs. With this regard, a Likert scale question has been prepared for the respondents' opinions. In response to the 7 lists of ideas, the respondents strongly agreed (Overall Mean = 4.34) that accessing micro-loans has a positive effect on their income and capital. On the other hand, for a similar list of ideas about the benefits of membership in microfinance institutions they also strongly agreed (Overall Mean = 4.25) that they are highly satisfied by the service, waiting time, and economic benefits given by MFIs and saving and credit associations.

The final objectives of the study are to measure the micro-loans impact on assets and change in capital structure. In response to this 92.3% agreed that their capital was improved and 79.6% said the capital structure has also been changed. The rest 7.7% and 20.4% restricted from giving their opinion respectively. From the data found from the financial statements of the SMEs, the change in capital structure has been witnessed by the results in year 1 and year 5. In year 1 the total debt-to-equity ratio was 0.62:1 while in year 5 the ratio changed to 1.01:1 (instead of showing each company's ratio the researcher sums up all the results and does the debt-to-equity ratio). The result about total asset improvement the data from the financial statements of the respondents show that the minimum improvement between year 1 and year 5 is 19% while the maximum is 179%. The mean change in the asset improvement is 75.33% which can be good evidence for the role of micro-loans in the improvement of SMEs.

## **5.2. Conclusion**

For a long time, financial institutions have been one of the major players in the economic development of countries. With the emergence of the modern economic system, these financial institutions became strong and accumulated a huge amount of capital. With this change, however, the focus of these institutions became directed at collecting savings from the poor so that they have

enough money to lend to the rich. However, with the emergence of small businesses and individual entrepreneurs, the need for microcredit has increased enormously.

As already cited earlier, the main objective of this study is to assess and measure the role of micro-loans in the growth of small and medium enterprises. From the results of the study, it has been seen that the role of micro-loans in the improvement of SMEs is very high. While studying the micro-loans accessibility was one of the major topics covered. The results witnessed that regular banks haven't given these companies a chance to access micro-loans due to several internal and industry-wide reasons. However, the existence of microfinance institutions and saving and credit associations improved access to micro-loans in SMEs. Membership in these institutions reduces the formalities needed to access loans, lessens the waiting period, decreases the collateral expected, and offers better interest rates than that of regular banks.

The improvement in the SMEs has been tested through both primary and secondary data analysis. Due to the improved access to micro-loans, initial and additional working capital needs by the SMEs have been enhanced. The impact on improvement has been tested with various measurement scales including income, capital, and profit. The results exhibit that except for a very few respondents, more than 90% showed improvements in all income, capital, and profit. Moreover, other behavioral factors including saving habits, record keeping, entrepreneurial characteristics, and money management have been studied and the results were all positive and impressive.

The test result on the improvement of asset in SMEs showed that through the five years data under study, the total asset of the businesses has increased significantly with both liability and capital improvements. However, the improvements in capital have been significant compared to the liability indicating that the micro-loans manifested a positive effect on net asset.

The attitude change towards capital financing is measured using the debt/equity analysis for the first and last years under study. The results indicate that the D/E ratio for the last year have been increased significantly with increasing debt financing implying that the SMEs' attitude to finance their business with only their own money has been changed.

### **5.3. Recommendation**

After the review of the findings, the researcher recommends:

- From this study the researchers understand that the gap between demand and supply for micro-loans is still high. Considering this, regular banks need to involve in availing micro-loans for SMEs and other small entrepreneurs and the government should formulate policies that encourage microfinance institutions and saving and credit associations in the country.
- The study reveals that the National Bank of Ethiopia policy doesn't necessitate regular banks to reserve some of their lending funds to micro-loans. Therefore, for regulatory bodies including these kinds of policies in their strategy will help SMEs to have options for finance and narrow the gap between demand and supply.
- From the observations of the study, it is clear that saving and credit associations that are actively participating in supplying of micro-loans are not governed by the NBE policies and procedures. Due to this, they manipulate the system to extremely benefit them than the users. Therefore, the NBE need to include these institutions in the policies for microfinance institutions or must formulate new policies to govern the associations.

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## ANNEX

### Addis Ababa University

### A questionnaire for postgraduate study in the Department of Accounting and Finance

This questionnaire is designed to gather information for the preparation of a master's degree in partial fulfillment research at Addis Ababa University College of Business and Economics Department of Accounting and Finance. The title of the study is: "*The Role of Micro-Loans in Capital Generation for the Society – The Case of Addis Ababa City*" and the information will be gathered from people who are beneficiaries of loans from microfinance institutions located in Addis Ababa.

The researcher would like to thank you for your willingness to give accurate information to support this study. Feel free on your answers, knowing that your responses will never go beyond the purpose of the study.

The composition of this questionnaire consists of three parts, the first part focuses on the social identity of the respondent, and the second covers the main issues related to the study. The third and final part of the questionnaire contains conclusion quires.

Note:

- You are not required to write your name.
- Describe your answer to the questions (unless they need to be answered in writing) by making (X) or (✓).

#### Part One: Questions about the person completing the questionnaire.

1. Sex:            Male                        Female           

2. Age:

20 - 30                        30 - 40                        40 – 50                        Above 50           

3. Education:

Secondary school  Certificate  Diploma

First Degree  Second Degree

Specify if other than this \_\_\_\_\_

4. Your experience in the field of work.

Less than one year

Between 1 and 5 years

Between 5 and 10 years

Above 10 years

5. The form of business you are engaged in

Sole proprietorship

Partnership

Share company

Cooperative

6. Field of work you are engaged in.

Service giving

Manufacturing

Retail

Other

If you answer 'Other' please state \_\_\_\_\_

7. What is your business growth index (growth pattern)

Incline  Decline

**Part Two: The main issue of the study explored.**

8. How long have you been a member of the microfinance institution you work with?

Less than 6 months

Between 1 and 5 years

Between 5 and 10 years

Above 10 years

9. How long did you wait to get loan service from the institution?

Less than 6 months

Between 6 months & 1 year

Between 1 and 3 years

Between 3 and 5 years

More than 5 years

10. Have you ever tried to get loan services from regular banks before going to microfinance institutions?

Yes, I did  No I didn't

11. If your answer for question number 9 'yes, I did' what response did you get?

I got a loan from the bank

The loan was not approved

12. If your answer to question number 9 is 'I get a loan from the bank' then why do you go back to a microfinance institution and apply for a loan? (More than one answer is possible)

High-interest rate

The amount of guarantee that is expected of me has increased more than I can afford

Because they could not give me as much money as I want

Because the loan process is tiring and tedious

If there is any other information that is not listed above, please mention it.

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13. If your response to question no. 10 is that your loan was not approved, what do you think is the reason? (More than one answer is possible)

Because I cannot present enough collateral

Not being able to complete the loan formalities

Because the bank is not willing to handle micro-loans

If there is any other information that is not listed above, please mention it.

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14. Did you have any other source of capital before contacting the microfinance institution?

Yes  No  Partially

15. If your answer to question no. 13 is no, how would you describe the capital generation option you got by being a member of this institution?

I found it excellent

It is a very good option

It is fair

It doesn't give me that much option

16. Items indicated in the table below relate to the positive impact of getting a loan from the institution on the capital and income of your enterprise. Thus, please indicate the level of your agreement or disagreement by using a scale of 1-5, where 1= strongly disagrees, 2= disagree, 3= neutral, 4= agree and 5= strongly agree

| S/N | Question items   | 1 | 2 | 3 | 4 | 5 |
|-----|--|---|---|---|---|---|
| 1   | Because of the loan from the institution, my total income has increased                                |   |   |   |   |   |
| 2   | Because of the loan from the institution, my profit has increased                                      |   |   |   |   |   |
| 3   | Because of the loan from the institution, I was able to easily meet my working capital need            |   |   |   |   |   |
| 4   | Because of the loan from the institution, my working capital has increased                             |   |   |   |   |   |
| 5   | Because of the loan from the institution, I was able to start a new business or improve the one I have |   |   |   |   |   |
| 6   | Because of the loan from the institution, I was able to change my business idea to reality             |   |   |   |   |   |
| 7   | Because of the loan from the institution, it taught me to use the money I have earned responsibly      |   |   |   |   |   |

If there is any other information that is not listed above, please mention it.

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17. Items indicated in the table below related to the benefits of membership in the institution for you or your enterprise. Thus, please indicate the level of your agreement or

disagreement by using a scale of 1-5, where 1= strongly disagrees, 2= disagree, 3= neutral, 4= agree and 5= strongly agree

| S/N | Question items  | 1 | 2 | 3 | 4 | 5 |
|-----|---|---|---|---|---|---|
| 1   | I easily became illegible for loan  |   |   |   |   |   |
| 2   | I get better interest rates and repayment schedules                           |   |   |   |   |   |
| 3   | Because I work with the institution, it helped to improve my book of records  |   |   |   |   |   |
| 4   | I have been able to easily get services that I could not get in regular banks |   |   |   |   |   |
| 5   | It has helped me to improve my economic benefit to a great extent             |   |   |   |   |   |
| 6   | Along with the loan benefits, it has helped me to develop my savings habit    |   |   |   |   |   |
| 7   | It helped me to become an entrepreneur and an employer                        |   |   |   |   |   |

If there is any other information that is not listed above, please mention it.

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18. Do you believe that your capital capacity has improved after availing of a micro-loan?

Yes  No  I can't say

19. Do you believe that your or your company's capital structure has changed by being the beneficiary of a micro-loan?

Yes  No  I can't say

**Part Three: conclusion quires**

20. Do you believe that you would have a better alternative source of capital if you were not part of micro-loans? If so, please let us know your options.

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21. Please let us know if there is any special benefit that you have received by being a beneficiary of the micro-loan.

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