DETERMINANTS OF FINANCIAL ACCESS AND THE EFFECT OF LOAN CHARACTERSTICS ON SME GROWTH IN BISHOFTU CITY

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Declaration

I, EMANUEL SEYOUM NADEW, hereby state that this thesis entitled “DETERMINANTS OF FINANCIAL ACCESS AND THE EFFECT OF LOAN CHARACTERISTICS ON SME GROWTH IN BISHOFTU CITY” is an original production of myself. This has been done individually under the direction of my academic advisor without any previous submission anywhere for awarding any academic degree. All sources referred to within have been adequately acknowledged.

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List of Acronyms

SMEs:	Small and Medium Enterprises
MOTRI:	Ministry of Trade and Regional Integration
NBE:	National Bank of Ethiopia
SPSS:	Statistical Package for the Social Sciences
OECD:	Organization for Economic Co-operation and Development
OLS:	Ordinary Least Squares
VIF:	Variance Inflation Factor
CDF:	Cumulative Distribution Function
MFI:	Microfinance Institution

Abstract

Small and medium enterprises (SMEs) play a crucial role in employment creation, income generation, and economic development; however, limited access to finance and unfavorable loan conditions continue to constrain their growth. This study examined the determinants of financial access and the effect of loan characteristics on the growth of SMEs in Bishoftu City, Ethiopia. A quantitative research approach with a cross-sectional research design was employed. Primary data were collected from 200 SMEs selected through stratified random sampling. Descriptive statistics, binary logistic regression, and multiple linear regression techniques were used to analyze the data. The binary logistic regression results revealed that collateral requirements, firm age, and financial record-keeping practices significantly influence SMEs' access to finance. Enterprises with better financial records and longer business experience were more likely to obtain financial services, while stringent collateral requirements reduced the likelihood of access. The multiple regression results indicated that access to finance, loan size adequacy, repayment flexibility, and financial institution support services have positive and significant effects on SME growth, whereas high interest rates negatively affect growth. The regression model explained 59.3% of the variation in SME growth, indicating substantial explanatory power. The findings suggest that improving SME performance requires not only enhanced access to finance but also loan products that are responsive to enterprise needs. The study concludes that financial institutions and policymakers should reduce collateral barriers, provide adequate loan amounts, offer flexible repayment arrangements, and strengthen financial and non-financial support services to promote sustainable SME growth.

Keywords: Small and Medium Enterprises, Financial Institutions, Access to Finance, SME Growth, Loan Characteristics, Bishoftu City, Ethiopia.

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Small and medium-sized businesses play an important role in the economic landscape of most countries as generators of jobs, innovations, and inclusive growth. Worldwide, SMEs make up around 90% of all businesses and contribute more than 70% of total employment, thus having a major public interest in the health of their finances (World Bank, 2020; OECD, 2019). In Sub-Saharan Africa, where high structural unemployment and economic inequality are some of the pressing issues, the importance of SMEs cannot be overstated (Ayyagari et al., 2011). Access to external capital or financing, specifically formal credit, is considered to be among the top determinants that decide about the future prospects of SMEs: their survival, scaling up, and contribution to economic change or lack thereof.

In this connection, Ethiopia is one such interesting case. Over the last few years, Ethiopia has been pursuing its economic agenda of industrialization and SMEs have been identified as crucial engines of employment creation, import substitution, and poverty reduction in its national developmental strategies (MoTRI, 2020). With this objective in mind, the Ethiopian government has set up the Federal Micro and Small Enterprise Development Agency (FeMSEDA) and implemented policies and regulations to formalize and promote SMEs by developing guidelines for commercial banks and micro-finance institutions to increase lending to SMEs (NBE, 2022). Nevertheless, research results indicate that SMEs in Ethiopia have identified lack of financial resources as the most critical challenge that restricts their operations and growth (Gebreeyesus, 2009; Endris & Kassegn, 2022).

In fact, the issue of financing constraints faced by small enterprises in emerging markets goes beyond their access to loans – it also concerns the specific conditions attached to credit availability. The size of the loan, the interest rate on the credit, loan repayment period, and related services provided by financial institutions affect the way finance influences the growth of enterprises (Beck & Demirgüç-Kunt, 2006; Stiglitz & Weiss, 1981). A loan provided at too high an interest rate can only exacerbate the problem of an enterprise's liquidity, making it impossible for the enterprise to grow. Furthermore, an inappropriate loan repayment plan might cause loan default when the business itself continues to be viable (Tiblet, 2020).Despite such interventions, many SMEs are faced with financial constraints

that make it difficult for them to grow effectively. Such constraints include the high requirement for collateral, high interest rates on loans, small loan amounts, and stringent repayment schedules (Ayyagari et al., 2011; World Bank, 2020). These are obstacle to SMEs' ability to invest in productive assets, adopt new technologies, and create more jobs.

The City of Bishoftu, situated roughly 47 kilometers southeast of Addis Ababa on the Djibouti road, is one of the fastest-growing secondary cities in Ethiopia. As part of the administrative structure of the East Shewa Zone in the Oromia Regional State of Ethiopia, Bishoftu has a vibrant commercial economy driven by service-based businesses, trading activities, and manufacturing industries. Being near Addis Ababa, the presence of crater lakes which attracts local tourism, and infrastructural development such as a proposed international airport are factors which have led to the formation and growth of businesses in the area. According to reports provided by the Bishoftu Town Investment Office, there are 480 registered SMES in the service, trade, and manufacturing sectors. However, many of these businesses lack formal financing, which hinders their ability to invest, grow, and employ more people (Kothari, 2004; World Bank Enterprise Survey, 2020).

The involvement of financial intermediaries in providing loans to SMEs in Ethiopia is influenced by structural and behavioral aspects. In terms of behavior on the part of SMEs, there is a lack of documentation in terms of the required finances, collateral, and credit history as some of the conditions imposed by financial intermediaries for obtaining loans (Berger & Udell, 1998). On the other hand, financial intermediaries view lending to SMEs as risky and cumbersome, hence, setting conservative standards that lead to credit rationing for most applicants (Stiglitz & Weiss, 1981). The aforementioned situation poses a structural challenge that has not been addressed by policy measures (Fanta, 2016).

Some researchers have focused on various facets of this issue in the Ethiopian situation. For instance, Gebreeyesus (2009) showed that there is a connection between constraints in access to credits and slow growth of employment and production within manufacturing small and medium-sized enterprises. Fanta (2016) concluded that the requirement for collateral is still the main problem of access to credits provided by banks in Ethiopia; financial organizations, at the same time, use relation lending to cope with the lack of information. Meressa (2022) proved that terms of lending, especially repayment schedule and quality of documentation, play an important role as factors predicting the possibility of obtaining financing. Recently, Endris & Kassegn (2022) emphasized that young companies and those having smaller size

are affected more adversely by financial constraints. Nevertheless, despite their contribution to the topic, most researchers work on a national or regional level and do not focus on city-level dynamics of both credit access and loan terms.

This is the background in which this particular study was developed. Through assessing the determinants of financial access as well as the impact of loans on the growth of small businesses in Bishoftu City specifically, this research produce empirical findings at the city level which have not yet been produced before. This particular research follows the use of the quantitative method using the cross-sectional approach where primary data is collected using survey from 200 SMEs. Binary logistic regression and multiple linear regressions were used to analyze the hypothesis of the study.

1.2Statement of the Problem

Small and Medium Enterprises are the pillars of most economies, forming up to 90 percent of the business organizations worldwide, while employing more than half the workforce globally (World Bank, 2020). In underdeveloped countries, Small and Medium Enterprises are the driving force for economic diversity, productivity, and poverty alleviation (OECD, 2017).As Ayyagari et al. (2011) highlight, not only do SMEs generate jobs on a large scale, but they also act as incubators for entrepreneurship and innovation—functions that become particularly relevant in countries that are yet to undergo structural change.

SMEs also provide a training ground for new business owners. In this situation, both state and nongovernmental groups began to focus on the development of SMEs. This necessitates placing the unique requirements of the business at the canter of the policy-making process and acknowledging that SMEs should be supported not because they are tiny but rather because of their capacity for efficiency, innovation, and competitiveness in both domestic and foreign markets.

SMEs are vital in achieving economic development and employment generation. Nevertheless, the ability of SMEs to grow and develop in Ethiopia is hindered by one critical factor, namely lack of access to finance (Beck et al., 2006).

Berger and Udell (1998) clarified that SMEs encounter problems in accessing funds due to the information asymmetry faced by the banks that view small business as a risky borrower.

Prior research from Ethiopia suggests that there are barriers that exist concerning access to loans, interest rates, terms for repayment, and other factors pertaining to institutions providing loans (Gebreeyesus, 2009; Endris & Kassegn, 2022). This creates an environment where firms lack the capability to invest in productive activities, adopt new technologies, or expand their workforce — outcomes that are ultimately detrimental not only to individual enterprises but to the broader urban economy of cities like Bishoftu.

The majority of the growing body of research on SME financing concentrates on national-level analyses or big cities like Addis Ababa (Alemayehu & Haile, 2018). Particularly in developing urban areas like Bishoftu City, there is a lack of empirical data on how financial institutions contribute to the expansion of SMEs at the city level.

Furthermore, a lot of research focuses on identifying factors that influence financing availability without adequately analysing how financial institution service features and financing availability relate to quantifiable SME growth outcomes like asset accumulation, employment expansion, and sales growth (Ayyagari et al., 2011). It is precisely for this reason that there is no holistic understanding on behalf of policy-makers and practitioners regarding the dual-stage operation through which financial institutions either facilitate or hinder the availability of credit, followed by the facilitation or hindrance of firm performance based on credit terms and conditions.

Financing constraints are among the largest barriers to firm growth in developing countries. Acess to finance significantly affects employment and productivity growth Ayyagari et al., 2008).

According to the findings of the current research, an interdisciplinary approach that analyses both the factors determining access to financing by SMEs and the impact of loans on their development, as well as the link between the two processes in one research setting, is rare. Such a research void prevents an analysis of the dual role of banks: not only gatekeeping credit, but also structuring the loan terms.

Previous studies in Ethiopia mainly focused on determinants of access to finance, while limited attention has been given to the combined effect of loan characteristics and financial access on SME growth, particularly in is Bishoftu city. Fanta (2016) and Meressa (2022) have provided valuable insight through their research on the availability of credit on a national

level; however, neither study breaks down its results to a city-level analysis nor incorporates any non-financial support services within the growth model.

Consequently, this research tries to assess the role played by the financial institutions in shaping access to finance and the growth of the SMEs through loan attributes, financial accessibility, and institutional services(MoTRI, 2020). Therefore, a systematic empirical study is required to examine the role of financial institutions in influencing access to finance and SME growth in Bishoftu City.

1.3 Research Questions

This study is guided by the following research questions:

1. What factors influence SMEs' access to finance from financial institutions in Bishoftu City?
2. How does access to finance affect the growth of SMEs in Bishoftu City?
3. What is the effect of loan characteristics on SME growth in Bishoftu City?
4. To what extent do financial institution support services contribute to SME growth in Bishoftu City?

1.4 Objectives of the Study

1.4.1 General Objective

The general objective of this study is to examine the determinants of financial access and the effect of loan characteristics on the growth of small and medium enterprises (SMEs) in Bishoftu City.

1.4.2 Specific Objectives

1. To examine the factors influencing SMEs' access to finance from financial institutions in Bishoftu City.
2. To assess the effect of access to finance on the growth of SMEs in Bishoftu City.
3. To evaluate the effect of loan characteristics (loan size, interest rate, repayment period, and collateral requirements) on SME growth in Bishoftu City.
4. To examine the role of financial institution support services in enhancing SME growth in Bishoftu City.

1.5 Research Hypotheses

Based on the theoretical frameworks and empirical literature reviewed, and consistent with the specific objectives of this study, the following hypotheses are formulated and tested:

H1: Collateral requirements have a significant effect on SMEs' access to finance.

H2: Firm characteristics have significant influence on SMEs' access to finance.

H3: Access to finance has a significant positive effect on SME growth.

H4: Loan size has a significant positive effect on SME growth.

H5: Interest rate has a significant negative effect on SME growth.

H6: Repayment period has a significant effect on SME growth.

H7: Financial institution support services have a significant effect on SME growth.

This is based on Stiglitz and Weiss's theory of credit rationing (1981), which stipulates that the use of collateral and the features of an entity determine its ability to access credit, as well as King and Levine's theory of financial intermediation (1993), which holds that the nature of financial intermediation influences the growth of firms.

1.6 Significance of the Study

This study is significant because it provides insight into how financial institutions influence the growth of small and medium enterprises in Bishoftu City in practice. The study helps policymakers and local government authorities understand the key financial obstacles faced by SMEs, and it helps to change the framework to support SME. From the point of policy making, the results may help create credit guarantee policies, interest subsidy policies, and collateral policies that address the financing gap experienced by SMEs in secondary cities of Ethiopia.

Further, the study might help managers identify their gaps and constraints to their growth. In addition to that, financial institutions benefit from the results by gaining a clearer understanding of SME financing needs, enabling them to design more flexible loan products, appropriate interest rates, and supportive services that enhance SME performance and reduce credit risk.

SME owners and managers also benefit by becoming more knowledgeable, and when they need external finance, they are prepared based on the requirements to approve the loan and to continue their growth. For those practicing in the area of microfinance and development banking, this study provides locally relevant information about what design aspects of loans have the greatest predictive ability for enterprise growth.

Moreover, the research contribute to existing knowledge by providing localized data from Bishoftu City in addition to integrating access to finance and SME development into one conceptual framework, thus contributing to fill existing gaps and acting as a reference point for other researchers or practitioners interested in financing SMEs in urban areas. The methodology used in the research also presents a good example on how using both binary logistic regressions and multiple linear regressions together in one research could be advantageous, something that could inspire similar research done in the same area in Ethiopia and Sub-Saharan Africa.

1.7 Scope and Limitations of the Study

Geographically speaking, the scope of the current research study is defined by the Bishoftu City area, whereas the sample group consists solely of officially registered SMEs in the service, trade, and manufacturing sub-sector. The time scope is defined in terms of cross-sectional research design where all the data is obtained from one point in time, in 2025–2026. While the cross-sectional approach helps assess relationships among the variables, it does not provide the basis for causation and does not allow making statements about the order of the events.

Furthermore, the sampling procedure was based on available samples. SMEs that can be identified and accessed via the Investment Office in Bishoftu Town constituted the target population of the study. Informal firms that comprise an important proportion of economic activities are beyond the scope of the current study. Data on firm growth used in the research study are self-reported which poses the risk of response bias; nonetheless, validity and reliability procedures are used to control the problem, as described in Chapter Three.

1.8 Operational definition

An operational definition shows how each concept is measured in this particular study rather than giving only the theoretical meanings.

- Small and medium enterprises (SMEs) are businesses that are classified based on the number of employees and capital investment. As stated by the Ethiopian SME development strategy and international standards, SME are characterized by a limited capital base, small workforce, and owner-managed structure (OECD, 2017; World BANK, 2020).
- Financial institutions refer to those formal organizations, such as commercial banks and microfinance institutions that mobilize savings and provide credit and related financial services to businesses (Levine, 2005). Financial institutions such as formal banks and microfinance institutions provide loans, credit services, and support services to SMEs in Bishoftu City.
- In this study access to finance implies that SMEs are able to obtain financial services, particularly credit, from formal financial institutions when needed (Beck et al., 2006).
- Loan size refers to the total amount of credit obtained by an SME from a financial institution (Ayyagari et al., 2011). In Ethiopia, the amount received is relative to business needs.
- Interest rate refers to the percentage charged by a financial institution on borrowed funds (Stiglitz &Weiss, 1981).
- The repayment period refers to the duration allowed by financial institutions for loan repayment (Beck& Demirguc-Kunt, 2006). Repayment period is measured in terms of months or years and assessed in terms of adequacy and flexibility.
- Collateral requirements refer to the assets pledged by SMEs as security to obtain credit (Stiglitz& Weiss, 1981). In this study, collateral is operationalized as both a binary variable (whether collateral was required) and a continuous measure of the perceived burden of collateral requirements.
- Financial Institution Support Services: Non-financial services offered by banks and microfinance institutions, such as business counseling services, financial literacy education, and accounting assistance services, which go hand in hand with financing to help enterprises develop their capabilities (Beck & Demirgüç-Kunt, 2006; Endris & Kassegn, 2022).
- SME growth refers to a measurable improvement in firm performance over time. Growth is commonly measured using sales growth, employment growth, and asset expansion (Ayyagari et al., 2011; Beck et al., 2006).

1.9 Organization of the Thesis

Five chapters is constitute the structure of this thesis. Chapter One discuss the introduction to the thesis including the background to the study, statement of the problem, research questions, objectives, hypotheses, importance, scope, and limitations among others. Chapter Two is going to deal with the review of literature focusing on the theories and empirical literature related to the role of financial institutions in SME development. It followed by gaps in the existing literature together with the establishment of the conceptual framework. Chapter Three deal with the research methodology that include research design, methodology, population, sampling technique, data collection instruments, and techniques of data analysis.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

According to Western Sydney University (2020), A literature review means an understanding of previous area knowledge and debate on that area to prepare a final written document. This chapter includes a theoretical and empirical review of financial institutions and the growth of SMEs and the identification of gaps in the case of Bishoftu city. The main objective of research is to understand previous research findings on financial institutions and the loan characteristics that affect SME growth in one of the fast-developing cities, Bishoftu. In addition to that, this research paper provides the current research findings or recent studies in current times with the relevant concept of SME development.

2.2 Theoretical studies

The theoretical review part mainly focuses on explaining theories and concepts that deal with the idea related to financial institutions and the growth of small and medium enterprises (SMEs). It gives a foundation on the theory of the study by explaining the relationship between access to finance and SME development. This review also helps us see how financial institutions support small and medium enterprises to encourage their development (Mishkin, 2018).

The study mainly relies on three theories, namely financial intermediation theory, pecking order theory, and institutional theories (Myers & Majluf, 1984). These theories explain how financial institutions support the growth of small and medium enterprises and the challenges they face during the process to access the finance. Further, it explains the borrowing decisions and their financing behavior among small and medium enterprises. The role played by banks and microfinance institutions in providing financial services to SMEs. This institution, by supporting this small and medium enterprise, can make the business run to their operation efficiency by expanding their business (ledgerwood, 2013). This could happen by offering loans, credit facilities, and other financial supports.

This review is based on four different theories, which complement each other: the theory of financial intermediation, the theory of credit rationing, the pecking order theory, and Schumpeter’s economic development theory. This is not an analysis of independent

theoretical approaches; rather, the interaction between the theories that can help understand the mechanism behind the two-stage process in question examined.

2.2.1. What is an SME?

The issue of what constitutes an SME is a major concern in the literature. As part of efforts to provide the needed assistance in an organized manner, the Ethiopian government put forward its main policy framework concerning micro and small businesses in 1997 (FeMSEDA, 1997), which emphasized poverty alleviation, addressing unemployment among young people, and the problem of gender discrimination. It should be noted that the above-mentioned policy was further modified by the Ethiopian authorities in 2011 (MoUDC, 2011). The new strategy aimed at providing institutional support to MSEs, thus contributing to the growth of industry in local communities.

The main reason for this national strategy is to improve the financial ecosystem for small and medium enterprises by focusing mainly on weak economies like urban areas (MoUDC, 2011). However, the strategic framework outlines a fast mechanism for operational growth; the practical realization is heavily on credit availability.

2.2.2 Financial Intermediation Theory

The underlying framework of financial intermediation theory revolves around the study of how financial institutions act as necessary conduits linking capital surplus firms with borrowers needing commercial credit. The main functions played by such intermediaries involve mitigating transaction costs, resolving informational imperfections, and ensuring efficient allocation of capital for maximum productive capacity (Gurley & Shaw, 1960). However, in practice, many SMEs encounter major challenges due to huge levels of information asymmetry. Such a market problem stems from the fact that most small businesses do not have organized financial statements or accounting systems along with insufficient asset values to offer as loan security (Stiglitz & Weiss, 1981). As a result, commercial banking institutions are very cautious in evaluating their borrowing requirements. In solving such an impediment, banks act as delegated monitors, decreasing the cost of monitoring projects.

Furthermore, it is evident from various literatures that an efficient financial intermediation system ensures savings' allocation and mobilization, thereby encouraging economic growth (King & Levine, 1993). From the theoretical perspective, it is quite important to ensure

efficient intermediation so as to overcome issues of liquidity and make finance available to small businesses.

Ultimately this theoretical perspective highlights that stable and well-regulated financial institution support is an accelerator for the expansion of SMEs by decreasing financing barriers and allowing small firms to successfully execute lucrative commercial projects (King & Levine, 1993).

For our study, however, it is the recognition of failure conditions made by the theory of financial intermediation that is key to understanding the situation. Diamond (1984)'s theory of delegated monitoring demonstrates how banks are capable of lowering information costs for depositors provided that the cost of monitoring the borrowers themselves is relatively low. Since the cost of monitoring remains high in cases where a borrower does not have any accounting records or a track record of creditworthiness, this is one reason why financial firms would not include healthy small businesses in formal lending markets despite stringent regulation.

2.2.3 Credit Rationing Theory

The key assumption of credit rationing theory refers to the deliberate process in the marketplace wherein banks purposely set interest rates lower than the equilibrium rate under competitive conditions. The primary reason financial institutions employ this approach is that, in situations characterized large information asymmetries, the conventional interest rate may fail to regulate risks effectively. As a result, an adverse selection process may arise in the credit market due to increases in commercial bank lending rates (Stiglitz & Weiss, 1981).

Even the maximization of interest rates has some effects; therefore, this could result in increasing the default rate. Thus, this is the reason why a bank wants to control this to avoid any problem in adverse selection. Adverse selection and moral hazard may occur due to asymmetric information and an increase in interest rates, which may result in risky borrowers and investments, respectively. This situation causes the bank to decide to ration credit and not change interest rates. According to this theory, when the financial institution increases its interest rates, safe and risky borrowers become fewer since they are sure that their project cannot be successful at a high cost of borrowing. Furthermore, other factors of firms, including their age and financial standing, are very crucial for an SME to clear the asymmetric barrier set up by the bank (Stiglitz & Weiss, 1981). .

When applied to the case of Bishoftu, the credit rationing model would make the following testable predictions: collateral is used as the main tool for sorting out the credit market participants; the age of a firm and its financial statements serve as indicators of creditworthiness; the sector of operation have little significance since it provides little information on each borrower's risk profile. These predictions lead to hypotheses tested in Model 1. Critically, credit rationing implies that those firms that lack access to credit markets are selected based on non-random criteria. Specifically, it discriminates against young and poorly documented firms.

This theory supports why SMEs frequently face strict collateral requirements, limited loan sizes, and loan rejection despite having viable and profitable projects. Credit rationing can affect SMEs since many businesses have poor accounting practices and lack appropriate collateral. This results in a situation where even some profitable investments cannot get enough credit support.(Beck & Demirgüç-Kunt, 2006). The reason behind financial institutions seeing a collateral requirement as a safe way to segregate the risky borrower and the safer borrower. In Ethiopia, for example, where SMEs commonly point out their inability to access finances as a major constraint to growth, the problem of credit restriction becomes important.

2.2.4 Pecking Order Theory

This theory was introduced by Myers & Majluf in 1984 and indicates that the capital structure of the companies follows the particular pecking order and is mostly due to the presence of information asymmetry between the management of the firm and its outsiders. As opposed to adhering to a predetermined debt/equity ratio, companies opt for sources of financing where information asymmetry is minimal. More specifically, the company opts for internal sources such as retained earnings in the financing of new projects.

For SMEs, internal funds are often insufficient due to low retained earnings, while equity markets are generally inaccessible. As a consequence, SMEs rely heavily on bank loans and microfinance credit. Recent evidence from African SMEs supports this argument, showing that internal financing dominates and that profitability is negatively related to debt usage, which is consistent with Pecking Order Theory (Calabrò & Mussolino, 2025; Ivashkovskaya & Solntseva, 2019). In the study of SMEs operating in Bishoftu City, this behavioral hierarchy undergoes a sharp change because the equity market is almost inaccessible.

The pecking order framework has a specific implication for this study that goes beyond simple description of financing preferences. If SMEs are forced to borrow at high interest rates not because they prefer debt but because it is their only available option then interest rate burdens directly erode the internal cash reserves that the theory identifies as the preferred and most efficient funding source. High borrowing costs therefore impose a double penalty: they reduce current profitability and deplete the internal resources that would otherwise fund future investment without external financing costs. This mechanism explains why interest rate burden is hypothesized as a negative predictor of SME growth in Model 2.

2.2.5 Schumpeter's Theory of Economic Development

Joseph Schumpeter's theory of economic development postulated that innovations were the main drivers of economic development because they involved entrepreneurial individuals capable of effectively using credit facilities provided by banks. Schumpeter noted that economic development did not result from the mere accumulation of capital but was achieved through entrepreneurs' innovations in terms of introduction of new ideas and changes within the business environment. These changes included introduction of innovative products, utilization of superior production methods, adoption of advanced technologies, and exploration of new markets. Thus, Schumpeter's theory focuses on innovation and entrepreneurship as the key factors in economic development (Schumpeter, 1942).

Joseph Schumpeter coined the term "creative destruction," which involves the replacement of traditional industries and less productive modes of operation by new industries. In addition to this, banking plays an important role because entrepreneurs need credit facilities to implement innovative projects until profit starts accruing from their activities. Such funding is especially crucial for small enterprises with limited internal resources. When SMEs, such as those operating in Bishoftu City, obtain financial support from formal institutions, they are better positioned to improve productivity, strengthen competitiveness, and expand their operations. Access to finance also encourages entrepreneurs to take calculated risks and invest in innovative activities that contribute to firm growth and broader economic development. In this regard, financial institutions serve as important facilitators of Economic transformation.

A modern empirical basis for this idea has been offered by King and Levine (1993), who found a strong connection between financial development and economic growth in a variety of countries. In this research, the theoretical background offered by Schumpeter changes the

nature of the growth problem. Instead of asking how SMEs survive, the problem lies in their capacity to invest and innovate and grow. If financial intermediaries offer sufficient funding at an affordable cost, they become catalysts in the process of change and development. Otherwise, they limit the process. And this is the core of the loan characteristics hypotheses in Model 2.

Availability of credit enables entrepreneurs to purchase modern equipment, adopt improved technologies, and increase operational efficiency. However, when SMEs face credit rationing or limited financial access, their ability to innovate and expand becomes restricted, negatively affecting business growth.

2.2.6 Additional Relevant Perspectives

The study is supported by different theoretical perspectives that help explain the link between financial institutions and the growth of small and medium enterprises (SMEs) in developing countries. Among these perspectives, the trade-off theory is considered relevant because it suggests that firms make financing decisions by balancing the possible gains of borrowing with the risks connected to financial difficulties. Nevertheless, the theory may not fully apply to small businesses since many SMEs face challenges such as limited capital access and financial instability (Frank & Goyal, 2009).

For an SME in Bishoftu, high formal interest rates and strict collateral requirements shift the trade-off equilibrium. In a city like Bishoftu, loan sizes, repayment periods, and prohibitive collateral thresholds often exceed the loan value. These perspectives support the relevance of focusing on financial institutions and credit conditions in the analysis of SME growth in Ethiopia. The theory shows that access to finance depends on the quality of legal systems, property rights, and financial regulation, with weak institutions intensifying credit constraints in developing countries (Beck et al., 2003).This perspective proves that SMEs perform under Bishoftu city their weakness not because of poor performance rather structural gap to support entrepreneurs.

2.3 Empirical Literature Review

This section examines previous empirical findings concerning the contribution of financial institutions to the growth and performance of small and medium enterprises (SMEs). Particular attention is given to issues such as access to credit, lending conditions, and the non-

financial support provided by financial institutions to SMEs. Both international and Ethiopian empirical evidence are considered in order to position the current study within existing research and to identify remaining gaps.

2.3.1 Access to Finance and SME Growth

There is an evident positive correlation between financing and growth of SMEs according to much empirical evidence. Using cross-country firm-level data, Beck et al. (2005, 2006) show that firms whose development relies on sources of funds from outside the company may have the capability to extend their growth when compared to those firms that do not have the option because they face constraints. The study's results also indicate that financing constraints affect SMEs more severely than large firms, particularly in developing economies. While large firms can access cash flow through equity issuance or other alternative channels, SMEs depend only on financial institutions (Ayyagari et al., 2011).

However, what is particularly significant about this body of international research is not just the direction of the findings but their size and consistency even within vastly varying institutional environments. In sub-Saharan Africa, South Asia, and Latin America, the relationship between financial exclusion and constrained economic growth is based on the same set of mechanisms: the inability to invest in physical assets, the inability to properly handle working capital, and the inability to capitalize on market opportunities. Consistency across institutional contexts makes it easier to make an analogy with Bishoftu – although it should be noted that institutional characteristics unique to Bishoftu will determine the exact nature of the constraints involved.

One major problem that faces developing countries is the availability of access to finance, and it is a barrier for the country's development. This problem mainly affects the industry's ability to create new things and expand the business that is on the ground. Furthermore, recent studies by Endris and Kassegn (2022) found that small enterprises face disproportionate risk. This indicates that the structure of financial institutions in Ethiopia continues to limit the growth potential of small and medium enterprises (SMEs). Evidence from empirical studies, including findings based on the World Bank Enterprise Survey, suggests that access to finance remains one of the major determinants affecting the performance and expansion of SMEs in the country (World Bank, 2020).

The most pertinent piece of evidence on this front is provided by Fanta (2016), who, investigating the situation among 102 small and medium enterprises engaged in manufacturing, concluded that requirement of collateral was the main factor constraining bank credit, as well as highlighting that Ethiopian financial institutions adopt both collateral-dependent and relationship-dependent standards for assessing loan applicants because of the higher risk posed by the SME market. The aforementioned findings are consistent with credit rationing theory in its claim about banks employing several signaling variables in situations of information asymmetry. However, Fanta's study did not consider one important aspect: the impact of credit terms on firm growth.

Several empirical studies conducted in Ethiopia indicate that financial limitations remain one of the major barriers affecting the performance of small and medium enterprises (SMEs). Research undertaken by Mulu Gebreeyesus demonstrates that difficulties in obtaining credit negatively influence firm expansion, labor growth, and productivity, particularly within manufacturing businesses (Gebreeyesus, 2009). Similarly, more recent studies argue that inadequate financial access reduces the ability of small and newly established enterprises to survive and grow in a competitive business environment (Woldemichael, 2019; Endris & Kassegn, 2022). These empirical findings imply that improving access to finance is essential for strengthening the sustainability and growth of SMEs in Ethiopia.

2.3.2 Loan Characteristics and SME Growth

Beyond access to finance, empirical studies emphasize that loan characteristics such as loan size, interest rate, and repayment period significantly affect SME growth outcomes. Research shows that larger loan sizes enable SMEs to acquire fixed assets, invest in technology, and finance working capital, which in turn supports sales and employment growth (Abay et al., 2014; Meressa, 2020).

However, high interest rates increase the cost of borrowing and reduce profitability, thereby discouraging long-term investment, especially for SMEs operating with narrow profit margins (World Bank, 2020). Empirical evidence further suggests that shorter repayment periods and rigid repayment schedules can increase liquidity pressure and raise the risk of default.

Studies also indicate that longer repayment periods and more flexible repayment arrangements improve SMEs' ability to manage cash flows and sustain business operations, thereby supporting stable growth over time (Beck & Demirgüç-Kunt, 2006; Tiblet, 2020).

The literature on the loan size shows, however, an important caveat that is often ignored: it is not the loan size itself but rather the loan size adequacy – matching the loan to the actual need that matters for growth performance. As reported by Aryeetey et al., fragmented credit markets in Africa are characterized by providing loans that are nominally available but in practice insufficient, creating a situation that one can call "partial funding," where borrowers are able to repay loans but unable to implement investment projects that will alter their growth prospects. These findings justify the inclusion of loan size, interest rate, and repayment period as key explanatory variables in the present study.

2.3.3 Financial Institution Support Services and SME Growth

Recent empirical literature highlights that the role of financial institutions extends beyond credit provision to include non-financial support services such as training, advisory services, and business mentoring. Beck and Demirgüç-Kunt (2006) argue that these services improve SMEs' financial literacy, record-keeping practices, and overall managerial capacity, which enhances the effective use of borrowed funds.

Empirical evidence from enterprise surveys and program evaluations indicates that SMEs receiving training and advisory support demonstrate better loan utilization, lower default rates, and improved long-term performance. In developing countries, support programs delivered through banks and microfinance institutions have been shown to strengthen managerial skills and competitiveness, although access to such services remains uneven across regions (Endris & Kassegn, 2022).

The justification behind this theory can be seen through the lens of the resource-based approach, articulated by Barney (1991). This model states that sustainable competitive advantage is not only dependent on the material and financial resources available to the company, but also upon the ability to make use of those resources via knowledge and skills. In the context of financial institutions' investments in improving SME managers' capabilities, the human resources are being developed to complement their financial investments and produce results which cannot be attained individually. As per this theory, such services should be considered as an independent factor in explaining the performance of SMEs, rather

than just being the means of providing credit.These findings support the treatment of financial institution support services as a distinct and important dimension of financial institution contribution to SME growth.

2.3.4 Empirical Evidence from Ethiopia

Most empirical studies on SME finance in Ethiopia are conducted at the national or regional level and focus on broad determinants of firm performance. For example, studies based on World Bank Enterprise Surveys examine how access to finance, infrastructure, and regulatory factors influence SME growth across the country (Gebreeyesus, 2009; Woldemichael, 2019).

Fanta (2016) investigated on 102 manufacturing SME's access to bank credit in Ethiopia using a binary logistic regression model. The study found that collateral requirements remain the major obstacle limiting SMEs' access to finance. The researcher further revealed that Ethiopian financial institutions simultaneously depend on collateral and relationship lending due to high perceived lending risk.

Meressa (2022) analyzed what drives formal credit acquisition among Ethiopian small and micro-scale businesses. The empirical results demonstrated that lending terms specifically collateral requirements, repayment schedules, financial record-keeping quality, and interest rates exert a substantial influence on an enterprise's credit eligibility.
However, empirical evidence at the city level remains limited, particularly for emerging urban centers such as Bishoftu City. In addition, existing studies rarely integrate access to finance, detailed loan characteristics, and financial institution support services within a single analytical framework.

This limitation in the literature motivates the present study's focus on SMEs operating in Bishoftu City.

2. 4 Research Gaps Identified

Based on the reviewed empirical literature, several gaps are identified. First, most Ethiopian studies rely on national or regional data, while city-level empirical analyses of SME finance, especially in Bishoftu City, remain scarce.

Second, few studies jointly examine access to finance, loan characteristics such as loan size, interest rate, repayment period, and collateral requirements, together with financial institution support services in a single model of SME growth.

Third, at the local level in Bishoftu city, evaluating how non-financial interventions that would help businesses mainly affect their performance indicators like SME revenue generation, job-creating programs, and asset gathering remain unsolved.

To summarize, previous studies in Ethiopia mainly focused on credit availability; they left out the impact of loan characteristics and financial access on the development of SMEs, particularly in Bishoftu city.

In addition, earlier studies largely emphasized access constraints without adequately examining how specific loan characteristics such as interest rate, repayment period, and loan size influence SME growth performance.

In short and precise research in Ethiopia they did not see in this angle the research wants to fill the gap by focusing on the determinants of financial access and the effect of loan characteristics on SME growth in Bishoftu city.

2.5 Conceptual frame work

Financial intermediation theory explains how financial institutions move saving and allocate credit to productive enterprises. The study focuses on financial access variable of the study is SME growth in bishoftu city.

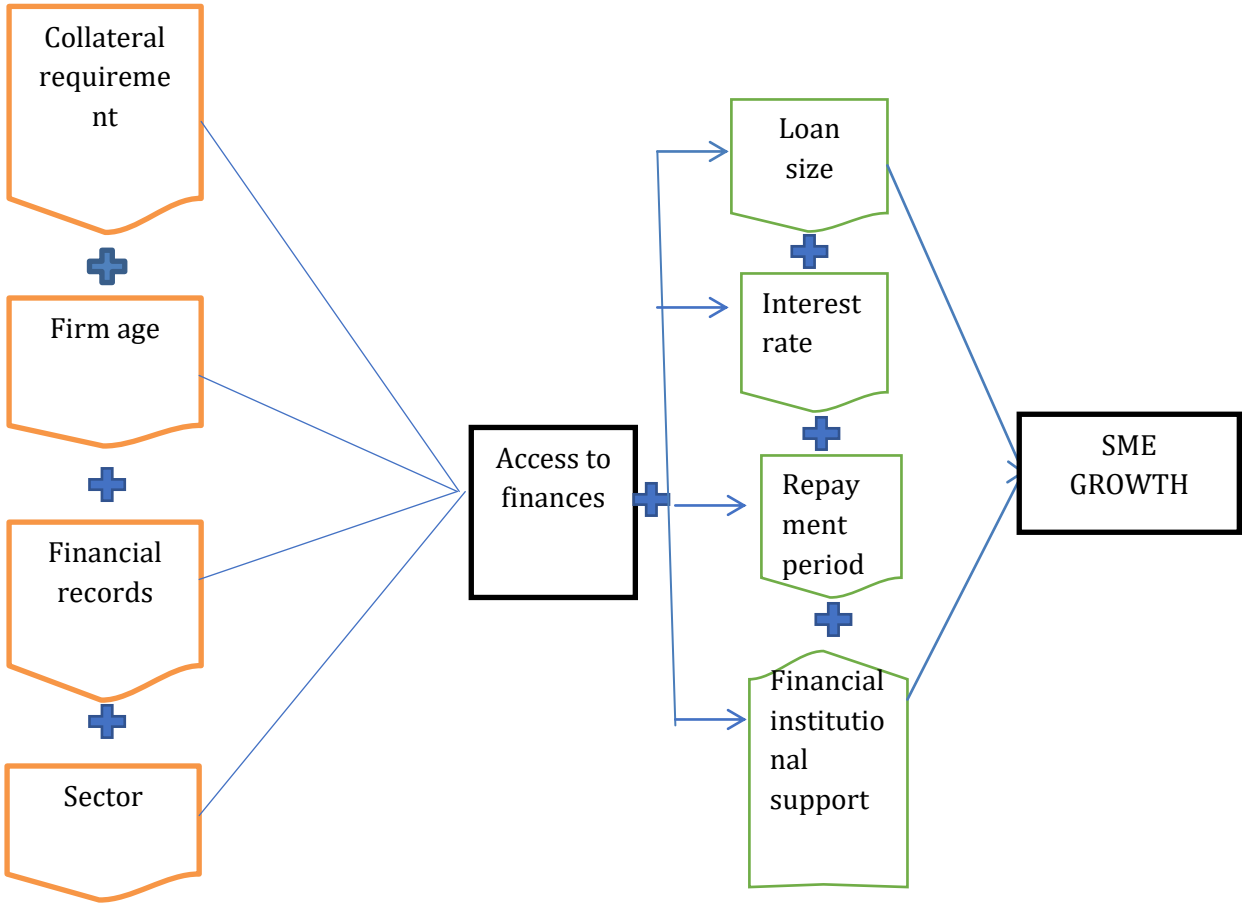
The theoretical framework on which this research is based is founded on financial intermediation theory, with two stages forming the basis of this analysis. The first stage sees the financial institution act as a gatekeeper, whereby the enterprise characteristics like availability of collateral, length of operation, quality of financial recordkeeping, and business sector determine whether access to finance is achieved for the SME. The model used here is the binary logistic regression since the outcome is dichotomous.

The second stage involves the institution acting as an architect, where the characteristics of the finance accessed, namely size adequacy of the loan, interest burden, repayment period flexibility, and institutional services alongside finance access, determine the growth possibilities available to firms. Growth here is defined on three levels: increase in sales, increase in employment, and increase in assets. Multiple linear regression will be used in this stage of the analysis.

However, by modeling financial exclusion and financial exploitation as a two-stage process, we capture an important aspect that is ignored by the one-stage model: namely, that while

both constitute barriers to SME growth, they are different in their operation and need a different policy solution. An excluded firm, at Stage One, requires a policy that reduces access barriers, while an exploited firm at Stage Two needs a policy that enhances the design of loan products. This is the key empirical insight of our study.

Figure 1 conceptual framework



Source: own compilation based on previous literature and finding.

CHAPTER THREE
Research Methodology

3.1 Introduction

As per C. R. Kothari (2004), research methodology refers to the methods and process employed by the researcher for solving research problems, collecting data, and meeting the research objectives. To do that, it needs investigation to reach an objective and to get an answer. It is an important procedure to get the result; the gathering should be aligned with the issue. This chapter mainly focuses on how financial institutions influence the development of small and medium enterprises in Bishoftu city.

3.2 Research Design

The design of the study operates as the primary framework or structure that controls the means of data gathering and analysis within the process to get result (Burns & Grove, 2003). Such a structure plays a significant role when it comes to exercising control over the potential variables that may affect the results obtained in the end. Besides, any investigation is considered to be a well-organized group activity aimed at answering research questions. Since there was a need to measure the extent of association between financial factors and business growth using empirical data, quantitative research methodology was employed (Creswell, 2014). The researcher chose cross-sectional research design, which is specifically suitable for such studies since it facilitates the collection of data from a variety of organizations within a given period.

Moreover, the study also utilized descriptive analysis technique. The selection of this technique was based on the assessment of existing state of affairs of the sampled enterprises. In other words, this type of analysis aims at describing reality in terms of business processes and results by means of using such methods of statistics as frequency, mean and standard deviation.

3.3 Research Approach

As stated by Mark Saunders et al. (2012), a deductive approach is a structure based on established theories and evaluating these theories in real-world experience. The researcher uses the deductive method because the research starts from theories to test if these theories have an effect, particularly on Bishoftu city. It is against this backdrop that the pecking order theory and the theory on economic development as postulated by Joseph Schumpeter were

taken into consideration so as to establish how financial institutions contribute to the development of SMEs in Bishoftu City. Research approaches are typically classified into three categories: qualitative, quantitative, and mixed-methods. According to John W. Creswell (2003), quantitative research is concerned with testing theories by means of numerical data and statistical analysis, frequently employing structured instruments such as questionnaires and surveys. In contrast, qualitative research emphasizes understanding social phenomena through the experiences, opinions, and interpretations of participants. This approach commonly utilizes methods including case studies, ethnography, phenomenology, and grounded theory to produce detailed explanations of a given issue.

For the present study, a quantitative research approach was adopted to examine the effect of financial institutions on the growth of small and medium enterprises (SMEs) in Bishoftu City. The quantitative method was deemed appropriate because it facilitates objective hypothesis testing and allows the researcher to examine relationships among variables using statistical techniques. Furthermore, quantitative findings can be generalized when the selected sample adequately represents the target population. Kobus Maree (2007) adds that quantitative research yields findings grounded in measurable evidence and logical analysis, thereby enhancing reliability and enabling comparisons with prior studies**.**

3.4 Description of the study

Bishoftu is a notable city situated approximately 47 kilometers from Addis Ababa, surrounded by seven crater lakes. As a rapidly growing urban center, it is planned to host the forthcoming New International Airport. The city is a popular destination for rest and recreation, featuring scenic mountains and a distinctive topography. Administratively, Bishoftu is encircled by several rural kebeles of the Ada'a district and is recognized as one of the expanding towns in the East Shewa Zone. The name "Bishoftu" originates from the Afan Oromo language and refers to an area characterized by the presence of multiple lakes.

The town lies at an altitude ranging between approximately 1,900 and 1,995 meters above sea level, which contributes to comfortable temperatures throughout most of the year. It is suitable for poultry production that reason many found in Bishoftu city. In addition to its environmental attractiveness, the town has experienced increasing expansion in trade, service delivery, and small business activities, making it an appropriate area for studying the role of financial institutions in the growth of small and medium enterprises (SMEs).

3.5. Target Population

According to Cooper and Schindler (2003), in research, the population refers to the total group of units that a study aims to investigate in order to make meaningful conclusions. Similarly, Abbott and McKinney (2013) A population represents the full group of units or cases that serves as the foundation of a data-based study. In research methodology, this complete group is called the target population.

To obtain accurate results, a study must focus on a specific population of entities. Accordingly, this research concentrates exclusively on the 480 small and medium enterprises (SMEs) that are officially registered and actively operating under the Bishoftu Town Administration.Records obtained from the Bishoftu Investment Office show that these 480 businesses make up the total group available for this investigation.

To make sure the data covers the different types of businesses in the town, these 480 SMEs were split into three those are185 Service, 166 trade and129 businesses. Every single one of these 480 elements was included in the study's scope so that different business sizes and industry features are fairly represented (Kothari, 2004).

3.6 Sample size

The primary purpose of selecting a sample is to obtain a group that accurately reflects the characteristics of the wider population. In line with this objective, the study employed a stratified random sampling technique as the main sampling procedure. This method was considered appropriate because it enables the researcher to divide a heterogeneous population into relatively homogeneous subgroups based on business categories (Kothari, 2004).

Accordingly, enterprises were classified into three strata: service, trade, and manufacturing sectors. This classification helped ensure proportional representation of each category of small and medium enterprises within the final sample. The application of stratified sampling also assisted in minimizing sampling bias and preventing overrepresentation of a single sector. As a result, the approach improved the reliability and precision of the statistical analysis while strengthening the internal validity of the study. The sample size was determined using the Yamane’s (1967) formula assuming a 95% confidence level and 5% margin of error. The sample size was calculated based on Yamane’s (1967) formula with a 95% confidence level and 5% margin of error.

$n = N \div 1 + N(e)\text{^}2$

=480/ ((1+480(0.05) ^2)

=480/ (1+480(0.0025)

=218

Where

n= required sample size

N=total target population size

e= precision/margin of error (0.05)

Therefore, n = 218 SMEs enterprises are sample size of the study

3.7 Sampling Techniques

To select the actual participants for this study from the total population, a clear sampling method is required. For this investigation, a final sample size of n = 218 SMEs was determined. To choose these specific enterprises, a probability sampling approach was applied, specifically utilizing a stratified random sampling technique.

In academic research, sampling methods are broadly divided into probability and non-probability types (Krishnaswami & Satyaprasad, 2011). Non-probability sampling selects units based on subjective choice, meaning elements do not have a known chance of selection (Barreiro & Albandoz, 2001). In contrast, a probability approach relies on random selection, ensuring every business in the population has an equal, fair chance of being included in the final sample (Krishnaswami & Satyaprasad, 2011). This randomized approach was chosen to ensure that minority business groups are properly represented and to keep the data free from personal bias.

When dealing with a population that is not uniform but split across different business sectors, a stratified framework is the most effective choice (Kothari, 2004). Using this method, the total population of 480 SMEs was divided into three distinct subgroups or "strata": Service, Trade, and Manufacturing. Afterward, random samples were drawn from each individual stratum to match their actual proportions in the town. To find the exact number of participants needed from each separate stratum, a standard proportional allocation formula was used (Kothari, 2004).The formula used for each stratum is

$$nh = \left(\frac{Nh}{N}\right) * n$$

Where

nh=Sample size for the stratum

Nh= Population size for stratum

N=Total population

n=Total calculated sample size

Table 1: Individual Sample Size Distribution

s/no	Strata	Population	Proportion	Sample size
1	Service	185	218*185/480	84
2	Trade	166	218*166/480	75
3	Manufacturing	129	218*129/480	59
TOTAL		480		218

Source: Researcher's Own Computation, 2026

As it shown in above tables, the target populations of SMEs were stratified based on their sector operation service, trade and manufacturing. To reach subgroup accurately reflects its actual percentage that reflects the population and minimizes sampling errors happen by selecting it was applied proportionate sampling method. At last questioners were distributed to the respondents using simple random sampling (lottery method) to select 218 SMEs samples.

3.8 Data Types and Techniques of Data Collection

Acquiring reliable data is the first step to make research own true and essential for making informed organizational decisions, needing the research standard regulation and procedure. According to C. R. Kothari (2004), usually, methods for way of collecting data fit into two parts the first part is: primary source in which the data collected in the first hand by the researcher and secondary sources the data collected by other researcher.

The study focused mainly on quantitative primary data collected through structured self-administered questionnaires. These were sent to owner-managers and senior managers involved in financial decision-making within SMEs. The questionnaire used a 5-point Likert scale from "Strongly Disagree" to "Strongly Agree" and included several types of closed-ended questions relevant to the study. Questionnaires are a common research tool because they provide an efficient way to gather a lot of information.in addition to that it is cost – effective when you try to collect data from large samples (Kothari, 2004). The questions

aimed to gather information on access to finance, loan details, and support services from financial institutions.

3.9 Data Reliability

Reliability is the stability of a measure of the measuring device; where, if the instrument is administered under similar conditions, the same results will be obtained at different points in time (Twycross & Shields, 2024). In this study, Cronbach's Alpha was employed to determine the consistency of the measuring scale. Cronbach's Alpha is the most common method of assessing the reliability of the measuring scales (Kothari et al., 2004). It is considered common practice to assume that a value of alpha at 0.90 or greater means high reliability, 0.80 to 0.89 is considered acceptable reliability, 0.70 to 0.79 is acceptable reliability, while values less than 0.69 are not reliable (Nunnally, 1967). The overall result of Cronbach's Alpha of the scale employed in this study was 0.735.

Table 2 Cronbach's Alpha Realibility Coefficients for Study constructs

Constructs	Items	Cronbach's alpha
Integrated SME Development scale	6	0.735

(Source: SPSS Output of Data Analysis, 2026)

In order to measure internal consistency, the criteria set forth by Nunnally (1967) were used, which define an alpha value greater than 0.90 as being excellent, between 0.80-0.89 as good, between 0.70-0.79 as acceptable, and less than 0.69 as unreliable. As recommended by Nunnally & Bernstein (1978) at 0.70 for basic research as a minimum, only variables scoring a value greater than 0.70 were selected. The tool had high internal consistency with a Cronbach's alpha of 0.735, thus providing reliable measures and creating a sound basis for the regression analysis.

3.10 validity

Validity checks whether that the technical theory part or construct address by questionnaire it is intended to capture (Hopkins, 2004). Both Content validity and internal validity were assessed in this study. Content validity was evaluated through expert review: the questionnaire was examined by academic supervisors and professionals in the field to ensure that the items accurately reflect the challenges and experiences faced by SMEs. A pilot test

was also conducted before full data collection to identify and address any ambiguities in the instrument.

3.11 Method of Data Analysis

In the process of statistical analysis, the initial field data had gone through a preparation stage whose main purpose was to narrow the gap that exists between collecting raw data and conducting formal hypotheses tests. From a methodological perspective, the data preparation stage is meant to ensure data accuracy while ensuring that fragmented and scattered pieces of data are transformed into structured form suitable for quantification (Cooper & Schindler, 2014). The process of data preparation stage ensures that complex raw field data is sorted out. The operational workflow for managing the gathered data followed a strict three-tier sequence data Editing, Coding Protocol, then finally the data, coded dataset was exported directly into the SPSS Statistics (Version 26.0) software.

3.11.1. Inferential analysis

3.11.1.1. Correlations

The gathered and edited data were then analyzed using SPSS Version 26.0. Descriptive and inferential statistics were employed. Descriptive statistics were utilized in summarizing data in the form of frequencies, percentages, means, and standard deviation. Inferential statistics involved binary logistic regression and multiple linear regressions.

The correlation among the variables was calculated using Pearson product-moment correlation analysis. It is a valid statistical method when dealing with the interval level of measurement involving continuous variables as found in Likert-type scale measurement (Daniel, 1990; Gravetter et al., 2000). The strength of correlation is rated by Henseler (2009), which states that 0.75, 0.50, and 0.25 correspond to strong, moderate, and weak correlation, respectively.

3.11.2. Multiple Linear Regressions

In this regard, as an analysis tool, regression modeling provides insight into how variation in the major dependent criterion is influenced by changes occurring in one or several independent criteria, providing the numerical underpinning to extrapolate a population's overall mean from specific sets of predictor values (Gujarati, 2005). The tool provides a powerful means for assessing the degree to which such statistically determined pathways in

inherently volatile data can withstand random or shock effects from external variables (Fabozzi, 2014). It is important to note, however, that according to Fabozzi (2014), correlation through statistical means does not imply cause-and-effect relationships. In cases where a given research design becomes more complex and involves determining the influence of a broad array of independent criteria on a singular outcome, multiple linear regression becomes an advanced statistical technique for analyzing these multivariate interactions (Aiken & West, 1991).

3.12. Binary logistic

In order to understand factors determining access to finances by SMEs, this research adopts the binary logistic regression technique. It is basically a statistical analysis approach used in the context of situations where outcomes are binary, either 'yes' or 'no'. In this regard, the question at hand would be whether the enterprise managed to get loan funding from a financial institution or not (Hosmer et al., 2013). In other words, this regression analysis can be seen as an extended form of normal linear modeling used to predict where each enterprise belongs out of the two categories (Field, 2018).For this reason; the accuracy of the regression analysis model was tested through two major tests of diagnostics. They include: Model Fit: This test of the model fit was performed using the Hosmer-Lemeshow test. Here, the objective was to see whether the regression model fit the data very well or not. A high p-value would indicate that our predictions were very close to reality. Explanatory power of the model: The ability of the model to explain differences among the dependent variable was assessed using the Nagelkerke value.

3.13. Model specification

To maximize the robustness of empirical results, this research implements the strategy of developing two models at once to identify the effects of various financial factors on enterprise development in the town of Bishoftu. Since the business performance and financial accessibility measures are essentially different in terms of measurement methods, from scaled perceptions to variables with dichotomous answers, the necessity of developing two econometric models arises (Gujarati & Porter, 2009). In its turn, the quantitative part of the study begins with the correlation analysis and further continues using the multiple linear regression model in order to evaluate the effect of varying degrees of perception of financial obstacles on enterprise development. Although the former is adequate for measuring continuous phenomena and index values, the second phase of econometrics implementation

consists of applying the binary logistic regression model because of dealing with categorical dependent variables (Hosmer & Lemeshow, 2013). More specifically, it may be applied when dealing with limited and bound variables, which take two states, such as receiving a loan from the bank and failing to get credit (Wooldridge, 2015).

Model 1: Determinants of Access to Finance (Binary Logistic Regression)

$$\text{Logit}(Pi) = \ln(Pi / (1 - Pi)) = \beta_0 + \beta_1 \text{Collateral} + \beta_2 \text{FirmAge} + \beta_3 \text{Records} + \beta_4 \text{Sector} + \varepsilon$$

Where:

Pi = Probability that SME accessed finance

Collateral=Collateral requirement perception

Firm Age = Age of the firm

Records = Quality of record keeping

Sector = Business sector dummy

Model 2: Effect on SME Growth (Multiple Linear Regression)

$$\text{Growth} = \alpha_0 + \alpha_1 \text{Access} + \alpha_2 \text{Loan Size} + \alpha_3 \text{Interest Rate} + \alpha_4 \text{Repayment} + \alpha_5 \text{Support} + \alpha_6 \text{Controls} + u$$

Where:

Growth = SME growth index (Sales/Employment/Assets)
Access = Access to finance dummy (1=Yes, 0=No)
Loan Size = Adequacy of loan amount
Interest Rate = Cost of borrowing
Repayment = Repayment period
Flexibility Support = Financial institution support service
U=error term

3.14 Ethical Considerations

Wellbeing of the participants was the highest concern during the conduction of this research. The participants were completely briefed about the objectives of the research. Participation was entirely voluntary.

High confidentiality was observed during the research; it was made clear to the participants that their answers would not be revealed nor misused against them and would be used only for academic purposes.

CHAPTER FOUR
DATA ANALYSIS, INTERPRETATION, RESULT AND DISCUSSION

4.1. Introduction

The findings of this study are described and analyzed in this chapter. It includes information related to the response rate, demographics of the respondents, descriptive analysis, correlational analysis, binary logistic regression analysis, and multiple linear regression analysis. All these types of analyses collectively help to answer the research hypotheses raised. In addition, it helps to understand the effect of financial issues on the growth of SMEs in Bishoftu. All the statistical tests were conducted using SPSS Version 26 on Likert scale data collected via questionnaire.

4.2. Response Rate

From a total of 218 questionnaires that were sent out, 206 came back, giving a response rate of about 95%. Of the six that had missing parts, those questionnaires were excluded from the data collection process, leaving only 200 completed questionnaires.

4.3 Demographic Characteristics of Respondents

In this section, the age group, educational background, the duration of service, and the position in which employees (respondents) carry their responsibilities were analyzed, interpreted, and presented. These respondents 'characteristics were focused on to ensure the reliability of the data collected. These data are nominal categorical data that describe and count the number or percentage of cases that participated in the research. Therefore, frequency analysis has been applied using version 26 of SPSS software.

Table 3 Ages of the Enterprises

	Ages of SMEs		
		Frequency	Percent
Valid	Less than 3 years	64	32
	3-5 years	97	48.5
	6-10 years	29	14.5
	Over 10 years	10	5
	Total	200	100

(Source: Survey Data, 2026)

The research result indicated that about 32% of SMEs operating in the town were below 3years and 48.5% were between 3 and 5 years. Whereas the businesses aged more than five (5) years were only about 14.5%. This finding indicated that the majority of the SMEs operating in the Bishoftu Town Administration have low business experience. This indicates that the majority of businesses in the phase of startup are young SMEs, and the enterprises that have survived is five years or less are fewer who manage to operate in business.

4.3.1. Educational Level of Respondents

The educational level of the employees has implications for which components are carried out in the SMEs' growth. The study analyzed the educational background of the respondents to assess the level of human capital and managerial capacity within the sampled SMEs. Education is a key factor that influences the quality of financial record- keeping and the ability to negotiate with formal financial institutions.

Table 4 Educational Level of Respondents

		Frequency	Percent
Valid	Lower degree	99	49.5
	Bachelor degree	53	26.5
	Master degree	34	17
	Higher degree	14	7
	TOTAL	200	100

(Source: Survey Data, 2026)

The educational level of respondents indicated that about 99 (49.5%) of respondents have a lower than a degree, followed by bachelor degree holders 53 (26.5%). This result indicated that the proportion of employees' educational level in the sectors is below a degree. It shows the workforce of Bishoftu City primarily consists of vocational or training skills, followed by bachelor's or first-degree holders, respectively, and finally master's and above. This table also indicates that there is a relatively low presence of higher- degree holders14 (7%). While the labor force is literate, there may be a gap in advanced managerial or specialized training. The fact that over half of the sampled SME owners have at least a first degree implies that human capital is not the primary slowdown for growth in Bishoftu.

4.4. Descriptive Analysis

Data have been gathered on the samples drawn from the population and analyzed using measures of central tendency (average, mean; that is, the average of the data set) and

measures of variation (standard deviation; that is, do the data points group around the mean, or is there an even distribution) have been done in this research study. The data obtained using the Likert scale can be treated as interval data, and as such, the mean and standard deviations are the most appropriate measures (Kerlinger, 1986).

Table 5 descriptive statistics

Statistics

		Loan size adequacy	Support services	Repayment flexibility	Access to finance	Collateral requirement
N	Valid	200	200	200	200	200
	Missing	0	0	0	0	0
Mean		3.37	3.12	3.37	.60	3.80
Median		3.00	3.00	3.00	1.00	4.00
Mode		3	3	3	1	4
Std. Deviation		.840	.926	.870	.492	.826
Skewness		.081	.122	-.052	-.393	-.078
Std. Error of Skewness		.177	.177	.177	.177	.177
Kurtosis		-.305	-.461	-.063	-1.865	-.745
Std. Error of Kurtosis		.353	.353	.353	.353	.353

(Source: SPSS Output of Data Analysis, 2026)

As seen in the table, the collateral requirement has the highest mean score (M=3.80, SD=0.826). It shows the highest mean with low standard deviation, showing that most SME owners agree that collateral is a barrier in the credit process. It is followed by loan size adequacy and repayment flexibility (M=3.37). Therefore, on average, the level of agreement of respondents indicates that these are a serious challenge to SMEs' growth. In the table, the mean access to finance (M=0.60) indicates that 60percent of SMEs successfully accessed credit. Furthermore, skewness and kurtosis values between -2 and +2 are considered acceptable to satisfy the assumption of normality (George and Mallery, 2010). Since all variables fell within the acceptable range, it confirms the normality of the data distribution.

4.5 Correlation Analysis

In this case, the study utilized Pearson Correlation in the evaluation of the correlation between financial factors and SMEs growth. As stated by Hogan et al. (2004), Pearson Correlation was selected due to the fact that the type of data used in this study is continuous. The correlation coefficient reflects the degree of the strength of the association between two

variables from 0 (where there is no relationship between the two) to +1 or –1 (perfect relationship). Positive correlation indicates that both variables move up or down simultaneously while negative correlation indicates that when one moves up, the other moves down

Table 6 correlation

Correlations

		Log SME growth	Access to finance	Loan size adequacy	Interest rate burden	Repayment flexibility	Support services
Log SME growth	Pearson Correlation	1	.538**	.556**	-.328**	.400**	.233**
	Sig. (2-tailed)		.000	.000	.000	.000	.001
	N	200	200	200	200	200	200
Access to finance	Pearson Correlation	.538**	1	.366**	-.077	.336**	-.008
	Sig. (2-tailed)	.000		.000	.293	.000	.911
	N	200	200	200	200	200	200
Loan size adequacy	Pearson Correlation	.556**	.366**	1	-.061	.105	.065
	Sig. (2-tailed)	.000	.000		.405	.153	.376
	N	200	200	200	200	200	200
Interest rate burden	Pearson Correlation	-.328**	-.077	-.061	1	-.098	-.052
	Sig. (2-tailed)	.000	.293	.405		.179	.479
	N	200	200	200	200	200	200
Repayment flexibility	Pearson Correlation	.400**	.336**	.105	-.098	1	.083
	Sig. (2-tailed)	.000	.000	.153	.179		.255
	N	200	200	200	200	200	200
Support services	Pearson Correlation	.233**	-.008	.065	-.052	.083	1
	Sig. (2-tailed)	.001	.911	.376	.479	.255	
	N	200	200	200	200	200	200

**. Correlation is significant at the 0.01 level (2-tailed).

(Source: SPSS Output, 2026)

The bivariate correlation analysis indicated in the table, all independent variable components are positive except interest rate burden, which shows a significant negative correlation (r= -.328). The Pearson correlation analysis result set out that the strongest relationship observed was between loan size adequacy(r= -.556) and access to finance (r=.538). The above table also indicates that the correlations are statistically significant relationships with SME growth ($p<.01$). However, the interest rate burden correlation indicates that higher financial cost hinders growth. SME growth is positively associated with access to finance, adequate loan size, repayment flexibility, and support services.

4.6 Logistic regression results: determinants of access to finance

According to Hair et al. (2010), binary logistic regression was selected for Model 1 because the dependent variable is dichotomous in nature. The model is appropriate since the access to finance is dichotomous (1=Accessed, 0=Not Accessed).

Table 7 binary logistic regression results

Variables in the Equation

		B	S.E.	Wald	Df	Sig.	Exp(B)	95% C.I.for EXP(B) Lower	Upper
Step 1[a]	Collateral requirement	-1.261	.284	19.745	1	.000	.283	.162	.494
	Record keeping	1.434	.419	11.695	1	.001	4.197	1.845	9.550
	Firm age years	.653	.112	34.003	1	.000	1.922	1.543	2.393
	Sector name			1.371	2	.504			
	Sector name(1)	-.372	.553	.454	1	.500	.689	.233	2.036
	Sector name(2)	.307	.484	.403	1	.526	1.360	.526	3.514
	Constant	.296	1.113	.071	1	.790	1.345		

a. Variable(s) entered on step 1: collateral requirement, record keeping, firm age years, sector name.

(Source: SPSS Output, 2026)

The binary logistic regression results in three variables: record keeping, firm age, and collateral as primary determinants of access to fiancé ($p<.05$). In addition to this, a firm operating for an additional year nearly doubles the probability of success (Exp (B) =1.922), and further record keeping increases the odds of access to finance by 4.197 times. However, collateral requirements act as a significant barrier, reducing the chance of access by (Exp (B) =.283). The results show that the business sector was not found to be statistically non-significant ($p=.504$), which suggests that credit accessibility is independent of industry type.

4.7. Multiple Regression Analysis

This analysis answered the research hypothesis regarding the extent to which access to finance and other variables affect SME growth. The goal is to develop an equation that determines the dependent variable in a linear function of corresponding independent variables (Varma, 2013). Generally, choosing a regression model, that is, selecting the variables to be included in a regression model, is a difficult task. Because of this real fact of life, it does not sound like saying that the perfect model can be developed (Jim Frost et al., 2018). But

whatever the situation is, the developed model should be able to fit the dataset. When building regression models, one of the biggest questions relates to "goodness-of-fit " (Jim Frost et al., 2018). To predict or estimate the result, the regression model should be a good fit. Therefore, before conducting the regression analysis, the ordinary least squares (OLS) method's assumptions should be tested. The major assumptions are presented here. Particularly, the assumptions of homoscedasticity, non-multi-collinearity, absence of outliers, zero mean value of residuals, and multivariate normality assumptions are good indicators of the goodness of the regression model for predicting the response variables. Unlike simple regression, multiple linear regression models are used to explain the linear relationship between several independent variables and a dependent variable that is observed. To do this, the model should be BLUE by fulfilling the following assumptions of the classical linear regression model.

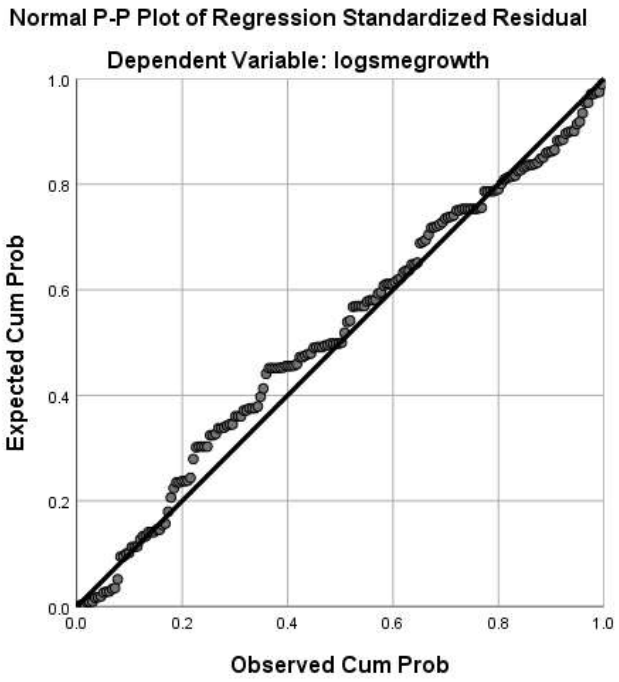
4.7.1.1. Outlier detection

In accordance with Barnett and Lewis (1994), an outlier in regression analysis is described as a data observation, where its dependent variable differs greatly from what is expected based on the equation. In order to determine outliers in the regression analysis, a boxplot analysis was conducted to establish extreme observations. Only mild outliers were established during the boxplot analysis.

4.7.1.2. Linearity Assumption

The presence of linearity within the data can be tested using the P-P (probability probability) plot of standardized residuals. Linearity indicates that the parameters of the predictors have a linear relation to the predicted value.

FIGURE 2 NORMAL P-P PLOT OF regression standard residuals for SME Growth



(Source: SPSS Output of the Research Data Analysis, 2026)

Linearity can also be assessed using the normal P-P plot of the regression standardized residual. The plot compares the empirical CDF of the regression standardized residual with the theoretical CDF of the normal distribution. This test focuses on the linearity of the residuals rather than the predictor linearity. If the residuals are linear, the points on the plot lie close to the line joining the origin to the top-right corner. As seen from the figure below, there are some deviations from the plot, but the points lie on the line joining the origin to the top-right. In other words, there is a linear relationship between the parameters of the independent variables and the predicted value of the dependent variable.

4.7.1.3. The Non-Multi-collinearity Assumption

A diagnostic check was conducted for multicollinearity prior to performing the regression analysis in order to ensure that there was no intercorrelation between the independent variables. Multicollinearity is a condition characterized by a very high level of intercorrelation between the independent variables, hence making it difficult to differentiate their individual impacts on the dependent variable (Jacob, 1969). In the case where there is multicollinearity, the estimations are unbiased. Nevertheless, the relative impact of the independent variables on each other and their overall impact becomes questionable. Hair et

al. (2010) opine that a VIF greater than 10 or a tolerance of less than 0.10 indicate multicollinearity.

Table 8 Correlation Matrix (Collinearity Statistics) of Independent Variables

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.359	.029		12.208	.000		
	Access to finance	.047	.008	.302	5.624	.000	.773	1.294
	Interest rate burden	-.023	.004	-.250	-5.244	.000	.985	1.015
	Support services	.015	.004	.179	3.748	.000	.984	1.016
	Loan size adequacy	.036	.005	.396	7.763	.000	.860	1.163
	Repayment flexibility	.019	.004	.217	4.301	.000	.874	1.144

a. Dependent Variable: log SME growth

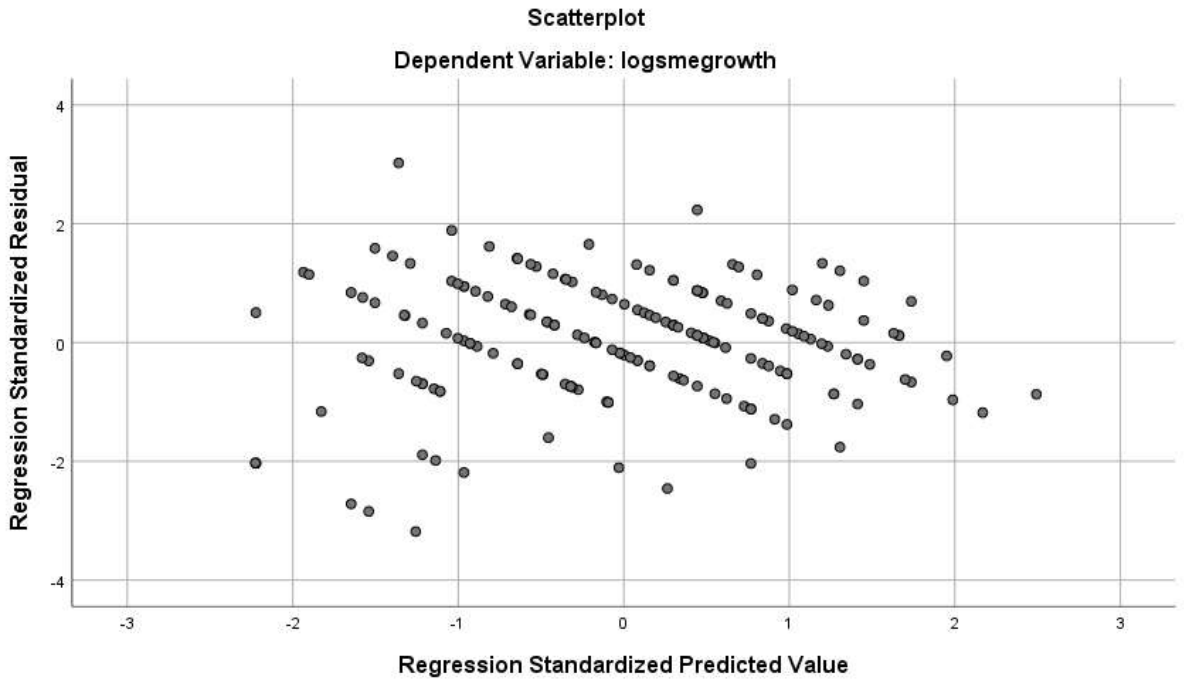
(Source: SPSS Output of the Research Data Analysis, 2026).

As seen from the table, the values of tolerance for all explanatory variables are significantly above the 0.10 threshold. Therefore, in this research, the independence of predictor variables is not violated in terms of the tolerance test. The VIF for all variables is below 10. That is, in this research, there is no problem of multicollinearity of predictor variables. Furthermore, the table shows that all significance value .000, which is less than the alpha level of 0.05. This approves that all predictors have a statistically significant impact on log SME growth**.** This not only satisfies the traditional alpha level of 0.05 but also meets the more stringent threshold of 0.005 proposed by Benjamin et al.(2018) to ensure higher reproducibility and stronger statistical evidence.

4.7.1.4. Homoscedasticity Assumption

According to Gujarati (2007), homoscedasticity is a situation in which the residuals in the relationship between the independent variables and the dependent variable are the same across all values of the independent variables.

Figure 3 Homoscedasticity Test



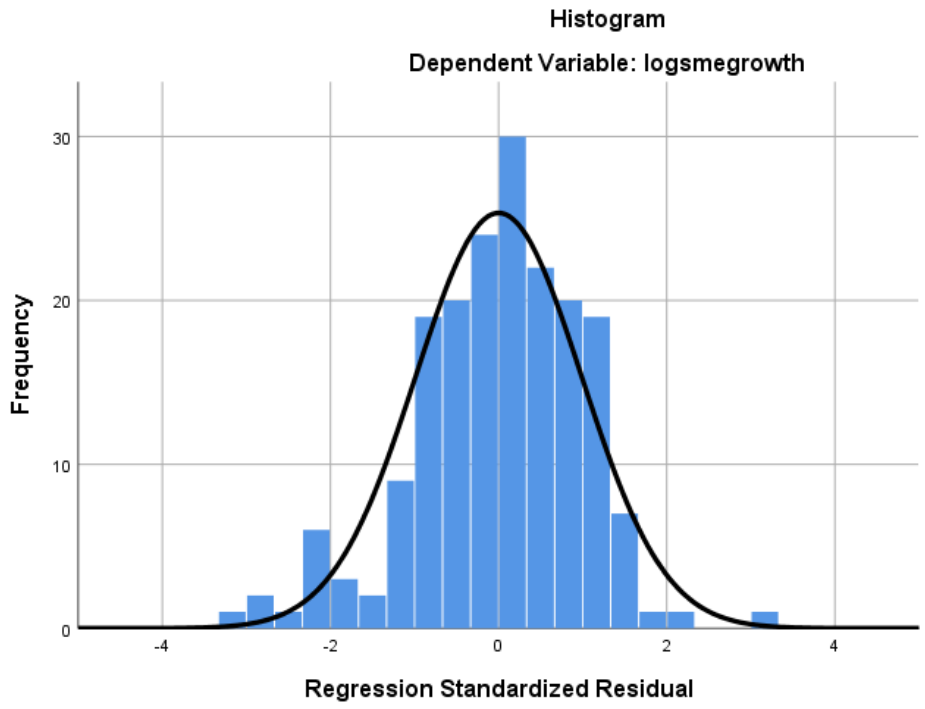
(Source: SPSS Output of the Research Data Analysis, 2026)

In the figure, the ballpoints on the residual plot appear to be randomly scattered around zero along the fitted (predicted) values along the x-axis without forming any systematic pattern such as a fan or bow –tie shape. Thus, the residuals do not systematically fall above or below the line across zero. This indicates the assumption of homoscedasticity was not violated.

4.7.1.5. Multivariate Normality Assumption

The first and most important assumption that must be met during multivariate analysis is that of normality, which denotes the shape of the data distribution of the individual metric variable in relation to its resemblance to a normal distribution, which is used as the standard for the statistical test procedures (Anderson, 2010). If the deviation from normality is significant when compared to normality, then all the statistical tests be biased since normality must prevail for the application of F- and t-statistics. The shape of normality consists of a symmetric bell shape in which the values lie mostly in the center.

Figure 4 Histogram of regression standardized residuals



(Source: SPSS Output the Research Data Analysis, 2026)

The histogram showing the frequency distribution of the residuals indicates that the mean of the residuals is approximately zero, and the standard deviation is close to 1.0. From these results, it can be concluded that the error terms of the data are normally distributed, confirming that the ordinary least squares (OLS) regression model is appropriate for analyzing SME growth.

4.7.1.6 Evaluation of the Goodness-of-Fit in the Regression Model

When building regression models, one of the most significant concerns relates to goodness-of-fit (Frost et al., 2018). Beyond the diagnostic assumptions already discussed, the primary measure used to evaluate goodness-of-fit in this study is the coefficient of determination, or R^2, following the recommendation of Hair et al. (2010). R^2 represents the proportion of the variance in the dependent variable that can be predicted from the independent variable(s). The value of R^2 ranges from 0% to 100%. An R^2 of 0% indicates a model that explains none of the variation in the response (dependent) variable around its mean, whereas an R^2 of 100% indicates a model that explains all of that variation. Generally, the larger the R^2, the better the

regression model fits the observed data. In practice, however, researchers rarely obtain a regression model with an R^2 of 100% (Jim Frost et al., 2018). In such a theoretical scenario, the fitted (predicted) values would equal the actual data values, meaning that all observations would fall exactly on the regression line and the error terms would be zero.

Table 9 Model Summary

Table Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.770[a]	.593	.582	.04948

a. Predictors: (Constant), repayment flexibility, support services, interest rate burden, loan size adequacy, access to finance

b. Dependent Variable: log SME growth

(Source: SPSS Output of Research Data Analysis, 2026)

As the table shows, the R value of .770 represents the multiple correlation coefficient. This shows a strong positive relationship between the independent variable and the dependent variable. In addition to this, the R-squared value of .593 indicates that 59.3% of the total variance in the growth of SME in Bishoftu is explained by the financial factors included in this model. Furthermore, the adjusted R-squared is.582 There is a small difference between R-squared, which confirms that the model is stable and that the predictors are adding real value to the explanation of SME growth rather than just adding noise. AS shown in the table, the standard error of the estimate .04948. These indicate that the actual data points are very close to the regression line, indicating that the model predictions are highly accurate.

4.7.1.7. Analyzing the overall significance of the regression model using the F-test

The F-test determines whether this relationship is statistically significant. Unlike t-tests that can assess only one regression coefficient at a time, the F-test can assess multiple coefficients simultaneously (overall significance). The F-test of the overall significance is a specific form of the F-test. The ANOVA (Analysis of variance) was conducted to test the overall significance of the regression model.

Table 10 ANOVA test for the model

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.650	5	.130	53.109	.000[b]
	Residual	.446	194	.002		
	Total	1.096	199			

a. Dependent Variable: log SME growth

b. Predictors: (Constant), repayment flexibility, support services, interest rate burden, loan size adequacy, access to finance

(Source: SPSS Output of Research Data Analysis, 2026)

The results in the table show that the model is highly significant. The F-test is 53.109 with p-value (sig.) of .000.Thus, it can be concluded that the F-test proved that all independent variables (repayment flexibility, support service, interest rate burden, loan size adequacy, and access to finance) together are significant predictors of SME Growth.

4.7.1.8 Analyzing the Significance of the Individual Predictor Variable using t-test

While the ANOVA results confirmed that the model is significant as a whole, the t- test was used to determine the significance and contribution of each individual independent variable to the dependent variable, SME Growth. The (R^2) and F-test are an overall measure of the strength of association and do not reflect the extent to which any particular independent variable is associated with the dependent variable. But the t-test reflects these Zikmund et al., 2000). The t-statistic is the ratio of B (unstandardized coefficients) of each independent variable to the standard error.

Table 11 The coefficients of variables

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	.359	.029		12.208	.000		
	Access to finance	.047	.008	.302	5.624	.000	.773	1.294
	Interest rate burden	-.023	.004	-.250	-5.244	.000	.985	1.015
	Support services	.015	.004	.179	3.748	.000	.984	1.016
	Loan size adequacy	.036	.005	.396	7.763	.000	.860	1.163
	Repayment flexibility	.019	.004	.217	4.301	.000	.874	1.144

- Dependent Variable: log SME growth

(Source: SPSS Output of Research Data Analysis, 2026)

As shown in the coefficients table, all predictors are statistically significant at the 1% significance level. This shows that all financial factors play a critical role in influencing the growth of SMEs in Bishoftu city. The most positive predictor in the model is loan size adequacy (B=.396, t=7.763). This result shows that when a financial institution supports the full amount of credit requested by an SME, it significantly boosts the firm's growth potential. The second most significant factor is access to finance (B=.302, t=5.624), which is also good for SME growth. Whereas the interest burden (B=-.250, t=-5.244) due to expensive loans, businesses SME struggle to grow. In addition to this support service (B=.179), it has a small impact compared to others, but it has a positive factor, as technical advice and training are helpful for the growth of SME.

4.8. Hypothesis Testing

In a previous attempt to explain descriptive analysis and diagnostic tests of the model assumption. The primary objective of this analysis is to test the research hypothesis formulated in Chapter 1. Hypothesis testing implies making a decision, on the basis of sample data, whether to reject or accept that certain restrictions are satisfied by the basic assumed

model. There are two methods to test a hypothesis. The classical and the alternative approaches are based on the p-values. The former approach takes the default alpha and the critical values. The second method, which was applied in this study, was called p-value (probability value), which is also known as the critical or exact level of significance. It is the most precise method; that is why the researcher 66 employed the method. More specifically, the p-value is defined as the lowest significance level at which a null hypothesis can be rejected. The null hypothesis is rejected for any $\alpha \geq \rho$ – value, while the null hypothesis is not rejected whenα α / - value.

Collateral requirement

According to Stiglitz and Weiss (1981), credit rationing occurs because of information asymmetry. Information asymmetry tells about how collateral serves as a signaling mechanism to reduce lender risk. In other words, the bank knows less about this institution, so in order to protect itself; they use collateral requirements instead of just raising the interest rate because it might attract only risky borrowers.

H0: Collateral requirements have no significant effect on SMEs' access to finance.

H1: Collateral requirements have a significant effect on SMEs' access to finance.

The results show there was a significant collateral requirement in this study ($\rho = 0.00$). Therefore, the researcher rejected the null hypothesis. It confirms the presence of credit rationing in the Bishoftu financial market. It proves that Bishoftu, access to finance is not determined solely by how profitable an SME is, but by the physical assets the owner can pledge. The finding is in agreement with the credit rationing model (Stiglitz & Weiss, 1981) since the theory suggests that the presence of collateral acts as a screening mechanism when there is asymmetric information in the market. If one SME has to satisfy strict collateral requirements, the probability of gaining access to funds will be at a mere 28.3% relative to another SME that does not face such requirements, all else being equal. This result supports the findings of Fanta (2016) regarding Ethiopian manufacturing SMEs.

Firm characteristics

According to Stiglitz and Weiss (1981), banks use firm characteristics as a mirror or solid foundation since banks cannot see the future; they look at the firm's age and its financial records. In addition to this, Beck and Demirguc-Kunt (2006) found that firm size and age are the most significant predictors of financial obstacles.

H0: Firm characteristics have no significant influence on SMEs' access to finance.

H1: Firm characteristics significantly influence SMEs' access to finance.

The results show that firm characteristics significantly affect access to finance (p<.05). Therefore, the researcher rejected the null hypothesis. This study aligned with the credit rationing theory of Stiglitz and Weiss(1981), the bank utilizes firm age and financial character as a screening tool to mitigate information asymmetry. The high predictive strength of record keeping, which raises the likelihood of access to credit four times or more, points to the usefulness of financial statements as indicators of credit worthiness in the Ethiopian credit market. This provides credence to the bank screening hypothesis by Berger and Udell (1998), and also to the finding by Meressa (2022) on the significance of the quality of financial statements in predicting credit access.

Access to finance

According to Joseph Schumpeter (1911), the bank acts as a gatekeeper to innovation. Capital is the lever that allows an entrepreneur to acquire the resources for growth. In addition to this, King and Levine (1993) provided a modern empirical extension of Schumpeter's work, which states that financial development and access lead to faster economic growth.

Ho: Access to finance has no significant positive effect on SME growth.

H1: Access to finance has a significant positive effect on SME growth.

The results show that access to finance has a significant effect on growth (p=.000). Therefore, the researcher rejected the null hypothesis. It aligned with Schumpeter, without finance the entrepreneur is stuck. This finding is in line with the theory proposed by King and Levine (1993) about the role played by financial development in the growth of enterprises. It also matches with Schumpeter's notion about how credit helps entrepreneurs gain the inputs necessary for productive work. This research finding supports the results of the empirical studies conducted by Beck et al. (2006) and Gebreeyesus (2009).

Loan size

While Stiglitz and Weiss (1981) discussed access, they also noted that banks often practice ''quantity rationing. In addition to that Aryeetey et al.(1994) specifically studied African SMEs and found that fragmented financial markets often provide inadequate loan sizes that fail to meet the actual investment needs of the firm.

Ho: Loan size has no significant effect on SME growth.

H4: Loan size has a significant positive effect on SME growth.

The results show that loan size adequacy has a significantly positive effect on SME growth (B=.396, p=.000). Therefore, the researcher rejected the null hypothesis. Since the p-value is less than 0.05. This indicates that SMEs receive the full amount of credit they require for investment, which leads to higher growth rates. In this regard, this research extends the

literature on credit rationing (Stiglitz and Weiss, 1981; Aryeetey et al., 1994) through its showing that not only financing is important, but the sufficiency of the credit amount is crucial. Incomplete lending in the sense that a firm receives less than it needs may be a common phenomenon in the credit market of Bishoftu, and loan sufficiency is the most effective tool at hand for banks.

Interest rate

According to the pecking order theory (Myers& Majluf, 1984), it suggests that high costs of external debt drain the internal cash reserves needed for investment.

H0: Interest rate has no significant negative effect on SME growth.

H1: Interest rate has a significant negative effect on SME growth.

The result shows that it has a significantly negative effect on SME growth (B=-.250, p=.000). Therefore, the researcher rejected the null hypothesis. Since the p-value is less than 0.05. The negative coefficient indicates that when the interest rate increases, the firm's growth decreases.

Repayment period

According to Field et al. (2013), extending the repayment period or offering grace periods, financial institutions provide a required gap for investment to generate a return before the debt must be cleared. The more flexible the repayment, the higher the business profits.

H0: Repayment period has no significant effect on SME growth.

H1: Repayment period has a significant effect on SME growth.

The regression analysis showed that repayment flexibility has a positive and significant effect on SME growth (B=.217, p=.000). Therefore, the researcher rejected the null hypothesis. This explains that the duration and flexibility of the repayment schedule are critical for enterprise expansion. Positive association indicates that extended and flexible payment terms allow SMEs to coordinate debt payments with their earnings flows, lowering their liquidity constraints and facilitating the reinvestment of excess money into productive use. This is in line with the theoretical assertion of Field et al. (2013), as well as the empirical evidence of Beck & Demirgüç-Kunt (2006) and Tiblet (2020).

Support Service

According to Barney (1991), a firm's competitive advantage and growth are derived not only from tangible assets and cash but also from intangible knowledge, such as knowledge and skills. In addition to that, Kongolo (2010) noted that many SME failures in developing economies are due to a managerial gap rather than just a lack of funds.

H0: Financial institution support services have no significant effect on SME growth
H1: Financial institution support services have a significant effect on SME growth
The regression analysis showed that institutional support has a positive and significant effect on SME growth (B=.179, p=.000). Therefore, the researcher rejected the null hypothesis.

However, the beta values are lower than others, which proves money alone is not enough for SME growth. The positive impact is significant, proving that non-monetary aid provided by financial firms – such as financial education, advice, and accounting – significantly facilitates SME growth. The results confirm the resource-based view of the firm by Barney (1991), where growth is viewed both as a product of tangible money and intangible expertise. They also concur with the study by Kongolo (2010), where managerial deficiencies were identified as key factors contributing to SME failure in developing countries.

CHAPTER FIVE
CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

The general objective of the study was to assess the determinants of growth for small and medium enterprise of small and medium enterprises (SMEs) in the case of Bishoftu town. The study results were related to the research objectives and hypothesis. The researcher's general conclusion about the results and recommendations based on the research objectives is discussed in this chapter. Additionally, suggestions for future research were addressed.

5.2. Conclusion

The outcomes of binary logistic regression show that the presence of formal credits for firms in Bishoftu City depends on three factors at the firm level: the availability of collateral, firm age, and quality of accounting records. The business sector is not significant. These results have practical as well as theoretical implications.

In terms of theoretical contributions, these findings lend substantial support to the credit rationing model proposed by Stiglitz and Weiss (1981). The banking institutions in Bishoftu adhere strictly to the theory, where in view of their lack of information on the quality of potential borrowers, the financial intermediaries use observable signals such as pledging of assets and the quality of accounting records to identify applicants.

In terms of implications, it is clear from the analysis that the financial exclusion problem faced by Bishoftu firms is primarily one of documentation and collateral rather than viability. Enterprises with better documentation were more than four times more likely to get credit than those with poor documentation records (Exp(B) = 4.197). Undoubtedly, this is one of the most useful findings from the access analysis, as compared to age, which automatically grows with time; documentation can be easily managed by SMEs in a relatively short span of time with proper training.

In the context of collateral (Exp(B) = 0.283), it is confirmed that asset-based lending systems pose formidable challenges to young enterprises with minimal assets. This is because over eighty percent of enterprises surveyed in this study were found to have been in business for less than five years, meaning that they did not have any substantial.

5.2.1 on the Effects of Loan Characteristics on SME Growth

As evidenced by the multiple regression analysis results presented below ($R^2 = 0.593$, $F = 53.109$, $p < .001$), financial institutions' policies regarding loan conditions significantly affect SME growth. Together, five financial parameters explain nearly 59 percent of the variance associated with SME growth. This strong level of explanatory power suggests that the effect of financial variables on SME performance cannot be overlooked in any scenario.

The second strongest growth predictor is loan size adequacy (Beta = 0.396). This is perhaps the key finding of our study. To understand what loan size adequacy represents, one should consider what the variable measures. Loan size adequacy is related not just to having big loans, but more specifically, to a sufficient match between the amount borrowed and the real needs of enterprises. When there is a mismatch and enterprises do not get loans big enough to invest in their projects, growth will not occur at all. Enterprises will have to change their priorities and use the borrowed money for managing working capital instead.

Finance accessibility (Beta = 0.302) itself still stands out as a highly positive predictor even after considering the loan characteristics. Thus, the growth premium effect associated with the accessibility of financial services cannot be entirely accounted for by the loan conditions only; there are more elements of accessing banking institutions that positively contribute to business development, such as payment systems, savings instruments, and legitimacy.

The interest burden (Beta = -0.250) is responsible for a clear growth disadvantage. The negative influence of high-interest rates is realized in several ways: they undermine profits from investments, limit available financial resources to reinvest, and hinder financing ventures that have long-term results. When the majority of enterprises are newly established and face cash flow problems, such factors become even more critical, making the difference between enterprises with favorable conditions of financing and those suffering from high-interest rates.

5.2.2 Synthesis

When viewed collectively, it becomes clear that the study reveals a consistent two-step role played by financial organizations in the development of SMEs in Bishoftu City. The first step consists of acting as gatekeepers, where their selection process, especially concerning collateral requirement, denies many viable SMEs from receiving any formal credit. The

second stage involves the conditions of such loans received by the SMEs, which either lead to development if the loan size is sufficient and its interest rate does not place undue burden, or to debt servicing otherwise.

The fundamental finding of the study can be summarized in one sentence: the constraint to SME development in Bishoftu City is not entrepreneurial but structural. It lies within the structure of financial products and practices.

5.3. Recommendation

At the policy level, the Government of Ethiopia has recognized that SMEs are the key drivers of economic and social growth. To support policy as well as the performance goals of each SME, the researcher suggested the following recommendations.

- There needs to be an entirely new approach adopted by the financial institutions in the analysis and appraisal of the loans provided to SMEs by focusing on cash flow rather than asset-based evaluation of the loan. Given the results showing that having high-quality financial statements increases the chances of obtaining credit by more than four times, it can be concluded that information availability rather than asset ownership is the main determinant of the willingness of the lenders to provide credit.
- The Bishoftu Town Administration together with the city's job creation office need to put in place an organized financial literacy and record keeping training program for the SMEs that have been registered. Better record keeping tackles the problem of access most effectively and delivers multiple advantages as well; a good record now means access to credit tomorrow, which in turn results in a business history for the next period.
- The concept of loan size adequacy must be one of the basic principles of lending by banks whereby the loan amount authorized is adequate for the financing requirements of the investment projects mentioned in the application of the borrowing party. Being inadequately funded, according to the research, is the biggest shortcoming of the present-day credit markets. The business entity receiving only 40 percent of the required credit does not implement its investment project justifying the borrowings taken by it.
- The National Bank of Ethiopia must consider reviewing interest rate guidelines in relation to loans granted to SMEs in such a way as to minimize

the growth cost incurred due to high interest rates on loanable funds. In the event that market interest rates cannot be reduced through administrative intervention, then interest rate subsidies for qualifying SMEs can prove useful.

- The financial organizations serving in Bishoftu need to create advisory centers for SMEs, which will provide services other than financing. This research study shows that the assistance provided by financial institutions can also stand alone to contribute to the development process. From the lender's perspective, it is also advantageous as efficient money management reduces chances of default on the part of the business entity.

5.4 Suggestions for Further Research

The study focuses on traditional financial factors that affect SMEs' growth. Further research should investigate how digital bank platforms influence the growth of SMEs in ETHIOPIA. Since Bishoftu city has built a new airport, further research should investigate the impact of the tourism sector on SME financing. Further studies could investigate local land lease policies in Bishoftu to determine whether they affect the use of their business premises as collateral for expansion.

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Appendixes – I

ADDIS ABABA UNIVERSITY

SCHOOL OF POST GRADUATE STUDIES

ACCOUNTING AND FINANCE PROGRAM

QUESTIONNAIRE TO BE COMPLETED BY EMPLOYEES OF THE ORGANIZATION

DEAR RESPONDENT,

This questionnaires, is designed for conducting a study on DETERMINANTS OF FINANCIAL ACCESS AND THE EFFECT OF LOAN CHARACTERISTICS ON SME GROWTH IN BISHOFTU CITY for the partial fulfillment of the requirement for the award of Masters of science in Accounting and finance.

The questionnaire provides you with the opportunity to describe the extent to which your business experience with financial institutions. It will also help organization or the government to show the gaps that happens in the area, the small and medium enterprise business area.

The survey will take about 10-15 minutes to complete. You will find several kinds of questions about your organization to ensure that we have accurately obtained your viewpoint. The data collected will constitute a preliminary phase in the Determinants of Financial Access and the Effect of Loan Characteristics on SME Growth. The results of this study will be used for the purpose of the student assignment and will not be published. Thus, you are kindly requested to answer the questions honestly and you are assured that your responses will be treated confidential and used for only academic purpose.

Dear respondent I, kindly request your genuine feedback on each of the questions at your free will and be open to accept or reject to respond.

I thank you in advance for your cooperation!

With Regards,

EMANUEL SEYOUM

General Instruction

1. Do not write your name in any part of the questionnaire
2. Your frank response is vital for the success of the study
3. Give a short and precise answer for questions followed by blank spaces

Part I. Background Information (Tick the box with X or □)

1. **Level of Education of the respondents:**

   □ Primary School

   □ Secondary School

   □ Diploma/TVET

   □ Bachelor's Degree

   □ Masters and above

2. **Business Sector:**

   □ Manufacturing
   □ Trade
   □ Service

3. **Years in Operation:**
   □ 3-5 years
   □ 6-10 years
   □ Over 10 years

4. **Number of Employees:**

   □ Micro (Less than 5)
   □ Small (5 - 30)
   □ Medium (31 - 100)

5. **Legal Registration Status:**

   □ Sole Proprietorship

   □ Partnership

   □ PLC

   □ Cooperative

6. **Have you ever applied for a loan from a formal financial institution?**

   □ Yes
   □ No

7. If Yes, from which institution?

   □ Commercial Bank
   □ Microfinance Institution (MFI)
   □ Both

8. Was your loan application approved?

   □ Yes, fully approved
   □ Partially approved
   □ No, rejected

9. If rejected or partially approved, what were the reasons? (Select all that apply)

- □ Lack of collateral
- □ Incomplete business records
- □ Business deemed too risky
- □ High interest rates
- □ Other: _____

PART II: Main body of the Questionnaire

Please indicate your level of agreement with the following statements using *tick the box with X or* □

1=strongly disagree 2= disagree 3=neutral 4=agree 5=strongly agree

➢ **How does access to finance affect the growth of SMEs in Bishoftu City?**

Statement	5	4	3	2	1
Access to bank loans has been critical for my sales growth.	□	□	□	□	□
The loan enabled me to hire more employees.	□	□	□	□	□
Without external finance, my business would not have expanded.	□	□	□	□	□

SME growth indicators

10. Average annual sales growth over the past 3 years

- □ Decline
- □ No Change (0%)
- □ 1% - 10% Increase
- □ 11% - 20% Increase
- □ Above 20% Increase

11. Change in number of employees over the past 3 years:

- □ Decreased
- □ Remained the same
- □ Increased by 1-5 employees
- □ Increased by more than 5 employees

12. Expansion of equipment/machinery/premises over past 3 years:

- □ Significant Decrease
- □ Moderate Decrease
- □ No Change
- □ Moderate Increase

□ **What factors influence SMEs' access to finance from financial institutions in Bishoftu City?**

Statement	5	4	3	2	1
Collateral requirements are too high for my business.					
The types of assets accepted as collateral are limited.					
High interest rates discourage me from applying for loans.					
Application procedures are too complicated and lengthy.					
Lack of proper financial records hinders my access to loans.					

□ **What is the effect of loan characteristics on SME growth in Bishoftu City?**

Statement	5	4	3	2	1
The loan amount allowed me to expand my business operations.					
The interest rate charged was affordable and fair.					
The repayment schedule (monthly/quarterly) was flexible.					
Overall, I am satisfied with the loan terms and conditions.					

- **To what extent do financial institution support services contribute to SME growth in Bishoftu City?**

Statement	5	4	3	2	1
The training provided helped improve my financial management skills.					
Support services positively contributed to my business growth.					

GAAFFII QORANNOO

APPENDIX – I

YUNIVARSIITII ADDIS ABABA

MANAA BARNOOTAA BARNOOTA OLI AANAA

SAGANTAA HERREGAA FI MAALLAQAA

GAAFFIILEE HOJJETTOOTA DHAABBATAA TIIN GUUTAMU

KABAJAMAA DEEBII KENNAA,

Ani barataa mootummaa yunivarsiitii Finfinnee keessatti mootummaa digrii lammaffaa Accounting and Finance irratti barachaa jiru dha. Qorannoo "Murteessitoota Argannoo Faayinaansii fi Dhiibbaa Amaloota Liqii irratti guddina SME magaalaa Bishooftuu keessatti" jedhu irratti hojjechaa jira.

Kaayyoon gaaffii kanaa muuxannoo hojii keessan dhaabbilee faayinaansii waliin wal qabatee odeeffannoo walitti qabuudha. Akkasumas mootummaa ykn dhaabbilee irratti hanqinoota damee hojii xixiqqaa fi giddu galeessaa keessatti mul'atan agarsiisuuf ni gargaara. Gaaffiin kun guutummaatti daqiiqaa 10-15 fudhata. Gaaffilee adda addaa waa'ee dhaabbata keessanii irratti argitu. Odeeffannoon walitti qabamu hojii qorannoo kanaaf qofa kan oolu yoo ta'u hin maxxanfamu. Kanaafuu gaaffilee kana dhugaa irratti hundaa'uun akka deebistan kabajaan isin gaafanna. Deebiin keessan iccitii ta'ee hojii barnootaaf qofa ni oola.

Kabajaan,

Emanuel Seyoum

- □ Maqaa keessan bakka kamittuu irratti hin barreessinaa.
- □ Deebiin keessan qorannoon kun akka milkaa'uuf murteessaadha.
- □ Gaaffilee iddoon duwwaan isaanii kennametti gabaabaa fi ifatti deebisaa.

KUTAA I: Odeeffannoo Bu'uuraa (Mallattoo X ykn □ kaa'aa)

1. Sadarkaa Barnootaa Deebii Kennitootaa:

- □ Mana Barumsaa Sadarkaa Tokkoffaa
- □ Mana Barumsaa Sadarkaa Lammaffaa
- □ Dipiloomaa/TVET
- □ Digrii Jalqabaa
- □ Maastarii fi isaa ol

2. Damee Hojii:

- □ Oomishaa
- □ Daldalaa
- □ Tajaajilaa

3. Waggoota Hojii:

- □ Waggoota 3–5
- □ Waggoota 6–10
- □ Waggoota 10 ol

4. Baay'ina Hojjettootaa:

- □ Xiqqaa (5 gadi)
- □ Xiqqaa-Giddugaleessaa (5–30)
- □ Giddugaleessaa (31–100)

5. Haala Galmee Seeraa:

- □ Abbaa Qabeenyaa Tokkoffaa
- □ Shariikaa
- □ PLC
- □ Waldaa Hojii Gamtaa

6. Dhaabbata maallaqaa idilee irraa yeroo tokko liqii gaafattanii beektuu?

- □ Eeyyee
- □ Lakki

7. Yoo eeyyee ta'e, dhaabbata kami irraa?

- □ Baankii Daldalaa
- □ Dhaabbata Maayikiroo Faayinaansii (MFI)
- □ Lamaan isaanii

8. Gaaffiin liqii keessanii ni mirkanaa'e?

- □ Eeyyee, guutummaatti mirkanaa'e
- □ Muraasaan mirkanaa'e
- □ Lakki, kufeera

9. Yoo kufe ykn muraasaan mirkanaa'e, sababni isaa maal ture? (Kan hojii irra oolan hunda filadhaa)

- □ Qabeenya wabii dhabuu
- □ Galmee hojii guutuu dhabuu
- □ Hojiin balaa qaba jedhamee tilmaamame
- □ Dhala ol'aanaa
- □ Kan biraa: _____

Mee sadarkaa waliigaltee keessanii agarsiisaa

(5=Baay'ee Walii Gala, 4=Walii Gala, 3=Giddu Galeessa, 2=Walii Hin Galu, 1=Baay'ee Walii Hin Galu)

	5	4	3	2	1
Argannoon liqii baankii guddina gurgurtaa koo keessatti murteessaa ture.					
Liqiin hojii dabalataa hojjettoota qacaruu na dandeessise.					
Maallaqa alaa malee hojii koo babal'isuun hin danda'amu ture					

Agarsiistota guddina SME

10. Guddina giddugaleessaa gurgurtaa waggaa 3 darban keessatti:

- □ Hir'ina
- □ Jijjiirama hin qabu (0%)
- □ Dabalata 1% – 10%
- □ Dabalata 11% – 20%
- □ Dabalata 20% ol

11. Jijjiirama baay'ina hojjettootaa waggoota 3 darban keessatti:

- □ Hir'ateera
- □ Akkuma turetti hafe
- □ Hojjettoota 1–5 dabaleera
- □ Hojjettoota 5 ol dabaleera

12. Babal'ina meeshaa/mashiinaa/iddoo hojii waggoota 3 darban keessatti:

- □ Hir'ina guddaa
- □ Hir'ina giddu galeessaa
- □ Jijjiirama hin qabu
- □ Dabalata giddu galeessaa

Wantoonni mootummaa maallaqaa irraa argannoo maallaqaa SME irratti dhiibbaa geessisan maal fa'i?

	5	4	3	2	1
Ulaagaan wabii hojii koo irratti baay'ee ulfaataadha.					
Gosoonni qabeenya wabii ta'anii fudhataman muraasa.					
Dhalli ol'aanaan liqii gaafachu irraa na dhoowwa.					
Adeemsi iyyannoo baay'ee walxaxaa fi yeroo dheeraa fudhata.					
Galmee maallaqaa sirrii dhabuun argannoo liqii koo gufachiisa.					

Amaloonni liqaa guddina SME magaalaa Bishooftuu irratti dhiibbaa akkamii qabu?

	5	4	3	2	1
Hammi liqii hojii koo babal'isuuf na gargaare					
Dhalli kaffalamu madaalawaa fi sirrii ture.					
Sagantaan kaffaltii deebii (ji'aan/kutaa waggaatti) laafaa ture.					
Walumaagalatti, haala fi mootummaa liqii irratti gammadeera.					

Tajaajilli deeggarsaa dhaabbilee maallaqaa guddina SME irratti hammam gumaacha?

	5	4	3	2	1
Leenjiin kenname dandeettii koo bulchiinsa maallaqaa fooyyesseera.					
Tajaajilli deeggarsaa guddina hojii koo irratti gahee gaarii qaba.					