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**THE EFFECT OF CREDIT ON JOB CREATION
PERFORMANCE OF MICRO AND SMALL ENTERPRISES
(MSEs) OPERATING IN ADDIS ABABA**

BY:

BINYAM TADESSE AYELE

September, 2020

ADDIS ABABA

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**BY
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(GSR/6247/11)**

**A RESEARCH SUBMITTED TO ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS IN PARTIAL
FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF
MASTER OF BUSINESS ADMINISTRATION (MBA FINANCE)**

ADVISOR: ALEM HAGOS (PHD)

**ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
MBA FINANCE REGULAR PROGRAM**

**September, 2020
ADDIS ABABA, ETHIOPIA**

STATEMENT OF DECLARATION

I, BinyamTadesse Ayele, hereby declare that this thesis entitled “ The Effect of Credit on Job Creation Performance of Micro and Small Enterprises (MSEs) Operating In Addis Ababa” submitted by me for the award of the Degree of Master of Business Administration (MBA Finance), to Addis Ababa University, Ethiopia, is my original work and it has never been presented in any university. All sources and materials used for this thesis have been duly acknowledged.

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This is to certify that the thesis entitled, “The Effect of Credit on Job Creation Performance of Micro and Small Enterprises (MSEs) Operating in Addis Ababa” is an original piece of work carried out by Binyam Tadesse under the supervision of Alem Hagos (PhD), and submitted in partial fulfillment of the requirements for the degree of Master of Business Administration in Finance (MBA Finance). It complies with the regulations of the university and meets the accepted standards with respect to originality and quality.

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ACKNOWLEDGMENT

First and foremost I would like to thank the almighty God for all his blessings in my life. I am very grateful to my wife, Rahwa Bahlbi and daughter, Abigail Binyam for the love and encouragement.

I am indebted to my advisor Dr Alem Hagos for his invaluable and wholehearted support throughout the research endeavor. My deepest thanks go to my friends Andinet Asmelash, Gari Umeta and Gadissa. Without you, my efforts would have ended in vain.

I also thank the data collection team for their dedication. The support of MFIs and MSEs that were providing data is highly appreciated.

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LIST OF ABBREVIATION

AEMFI	Association of Ethiopian Micro finance Institution
FSMMIDA	Federal Small and Medium Manufacturing Industry Development Agency
FUJCFSA	Federal Urban Job Creation and Food Security
GDP	Gross Domestic Product
GPI	Genuine Progress Indicator
MFI	Microfinance Institution
MSE	Micro and Small Enterprise
MSME	Micro and Small and Medium Enterprises
NBE	National Bank of Ethiopia
SME	Small and Medium Enterprise

ABSTRACT

MSEs are considered as the backbone of Ethiopian economy, and have the potential to significantly contribute to job creation and thereby poverty alleviation. The main aim of this study was to examine the effect of access to finance on job creation performance of MSEs. The sources of data for this study includes both primary (survey data) and secondary sources (reports). The study is mainly conducted based on a survey of 206 sample MSEs operating in Addis Ababa. The quantitative data generated through questionnaire surveys were analyzed using both descriptive and inferential statistical techniques through STATA version 20. Ordinary least square regression model was applied to estimate the effect of access to finance (measured by financial leverage) on job creation. The high R squared 85% of the variation in job creation is explained through financial leverage and firm characteristics. The study underlines the substantial role of credit for the job creation performance of MSEs. MSEs' job creation is significantly impacted by financial leverage and firm characteristics of enterprise size and firm age which is in an agreement with other studies. Unlike previous researches, the study couldn't find statistical significance to show the influence of firms economic sector types on job creation. The key findings of the research included availing financial access to MSEs is essential to unleash the potential of MSEs for job creation. The study recommended that policy makers should strive to mobilize more financial resources and put in place regulatory framework for the financial sector that encourage financial institutions to avail more financial access to MSEs, recognizing the role of financial leverage and firm characteristics on job creation performance.

Keywords: *MSE finance, job creation, microfinance, economic development*

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Job creation is the burning issue as unemployment reached 19% in Ethiopia. (CSA, 2018) Despite the broader changes within Ethiopia's economy, employment patterns have not substantially changed. According to JCC (2018), wage-employment increased slightly from 2005 (7.9%) to 2013 (10%) but remained below average for Sub-Saharan African countries in addition 49% were working without monetary compensation—essentially outside the country's growth cycle. (JCC, 2019) unemployment in urban areas remain widespread (IGC, 2012). The country still faces the daunting challenge of creating sustainable and inclusive jobs for a rapidly growing population, at a pace of two million potential new workers each year (World Bank, 2018)

Micro and small enterprises play an important role in the development of a country (Feeney and Riding, 1997). One of the major ways MSEs contribute to economic development is by creating employment for the growing labor force, providing desirable sustainability and innovation in the economy as a whole. In addition to that, large number of people relies on the micro and small enterprises directly or indirectly (Fida, 2008). The development of MSEs is seen as the way to accelerating the achievement of wider socio-economic goals, including poverty alleviation (Cook and Nixon, 2000).

From the socio-economic development viewpoint, MSEs provide a variety of benefits (Advani, 1997). They are more labor intensive than larger firms and they have lower capital costs associated with job creation. They play critical roles to ensure income stability, employment and economic growth (Liedholm and Mead, 1987; Schmitz, 1995). Ayyagari, Demirguc-Kunt, and Maksimovic (2011) show SMEs to be important job creators. The contribution which small businesses can make to national economy and wealth creation need to be recognized by the governments from the beginning and be considered as part and parcel of the economic development process.

There is a growing body of empirical literature that supported the fact that micro and small firms employ a large share of workers and create most jobs in developing economies (World Bank, 2013). Initially, Birch (1979) provided early evidence in support of the idea that small businesses are the primary engines of job growth. Meller (1981) concluded that smaller industries are more labor intensive and create more direct jobs. Kirchhoff and Phillips (1988) found that firms with fewer than 100 employees are the major sources of net new job creation. Haltiwanger, Jarmin, and Miranda (2010) suggests that startups and surviving young businesses are critical for job creation and contribute disproportionately to net growth. Haltiwanger, Jarmin and Miranda (2011) highlighted the important role of business startups and young businesses in job creation

Consistently, Ayyagari, Demircuc-Kunt, and Maksimovic (2011) shows that for 99 countries SMEs are important and in some cases, the biggest contributors to total employment and job creation, across developing countries). SMEs also have the largest share of employment in developing countries accounting for more than 71 percent of the jobs in the region. smaller, younger firms will have a higher rate of job creation due to rapid firm births. Freund and Rijkers (2012). On the other side, various researches question the

While an extensive literature exists on how finance can affect corporate investment and overall economic growth, comparatively little is known on the effect of finance on labor market outcomes. Arguably, the relationship between finance and job growth is more subtle, since it is not clear that increasing access to finance should readily lead to the hiring of more workers. (Ayyagari, Demircuc-Kunt and Maksimovic, 2011). A review of the relevant literature reveal that there is inconsistent findings on the effect of financial access on job creation (Yazdanfar(2012)

In the Ethiopian context, the number of jobs created by MSEs is increasing (EEA, 2014; FEMSEDA, 2014) However, the current state of MSEs leaves a lot to be desired. With dominance of microenterprises, job creation and employment remain to be far behind its potential (ADA, 2017). This can be attributed to various challenges ranging from systemic ones such as limited access to basic infrastructure and finance to operational difficulties like inadequate skill and lack of business development support (ADA, 2017; EAA 2014). But still access to finance is low in Ethiopia according to the World Bank (2015) which states that

only 1.9% small firms and 6% of micro firms have a loan or a line of credit; 50% of microenterprises and 40% small firms reported A2F is a constraint; and loan rejection rate of micro businesses is 57.3% whereas it reached 87.9% for small businesses. (World Bank, 2015).

The study is important in contributions to fill in the aforementioned literature and empirical studies gaps by investigating the effect of financial leverage on job creation in Addis Ababa, Ethiopia. Understanding the dependence of job creation on financial leverage will add to the inadequate documented knowledge in the Ethiopian MSE, finance and labor market. The knowledge could help policy makers and financial institutions in their roles and efforts to make access to finance available to MSEs for the purpose of job creation.

1.2. Background of MSE Sector in Ethiopia

The MSE sector is key in the strategic direction of the government. It is the engine of the job creation and economic development. (FEMSEDA, 2011; and World Bank, 2015)

The Government of Ethiopia five-year development plan emphasizes the key role of MSEs for the local economy and identifies support to MSEs as a key industrial policy direction for creating employment opportunities. A World Bank study on SMEs finance in Ethiopia finds that financing constraints of Ethiopian SMEs are one of the key obstacles to job creation and growth. Both demand-side and supply-side surveys clearly indicate the existence of a missing middle phenomenon whereby small enterprises are more credit constrained than either micro or medium/large enterprises (World Bank, 2016).

MSMEs have been high on the agenda of the government for the last two decades. The economic development plans of PASDEP¹, GTP I² and GTP II³ commonly recognized MSMEs as vehicle of development and key drivers of job creation and employment (ADA, 2017).

The current development plan, GTP II has put in place strategic direction for the development of the MSME sector with emphasis on production and productivity. In addition, the National MSE Development and Promotion Strategy in 1997; the Revised MSE strategy in 2011 with ambitious targets on employment creation and transition to medium size level; and the establishment of

¹ Plan for Accelerated and Sustained Development to End Poverty from 2005-2010

² Growth and Transformation Plan 2010-2015

³ Second Growth and Transformation Plan 2016-2020

FeSMMIPA and FeUJCFSAAs policy interventions prove the initiative of the government to support the MSEs.

Despite these strategies of the government, SMEs are constrained by both supply and demand side factors. According to Tegebu, Fredu&Seid, Edris. (2018), SMEs specific factors such as poor financial records of SMEs, lack of adequate collateral, SMEs poor management of risks, and informalities of SMES are the major obstacles underlined by banks and MFIs to their engagement with SMEs. In general, young firms who do not have adequate managerial and operation experience, and those with inadequate collateral are highly credit constrained. Access to finance is significantly influenced by the age of the firm, firm's previous engagement with banks, experience of the manager and whether firms are managed by the owner (owner-manager) or not (Tegebu, et al., 2018).

However, MSEs still face external barriers in terms of financial problems due to bad access to formal financial sources (Schmitz 1982; Hayashi 2002; Yoshino and Taghizadeh-Hesary 2017). The performance of MSEs depends on adequate funding (Ganbold, 2008).

As part of its reform agenda, GoE established JCC to govern, monitor and coordinate the job creation agenda. According to Pito (2019), JCC's role covers entrepreneurship and MSMEs. The Job Creation Commission has identified the need for a new MSME Strategy and aims to engage with the key ministries (MoTI, MoUDC and MoALR) and agencies i.e. FeSMMIPA and FeUJCFSA (Pito, 2019)

1.3. Statement of the Problem

MFIs are increasingly channeling credit for MSEs over the past decade. (EEA, 2014; NBE, 2018; and FEMSEDA 2014). However, prior researches agree that most of MSEs are still credit constrained in Ethiopia. MSEs are commonly referred to as "the missing middle" neither served by commercial banks nor by MFIs. (World Bank, 2015). In the same study, access to finance is rated as the top obstacle that hinders MSEs growth and affect their job creation performance.

The empirical research into the effects of financial leverage and firm level characteristics on job creation is limited to few studies, with mixed results leading to controversy. (Yazdanfar 2012). Cantor (1990) argued that highly leveraged firms tend to have more volatile employment and

capital investment. Nickell and Wadhvani (1991) indicated that employment decreases with the firm's leverage ratio. Similarly, Sharpe (1994) confirmed that the financial leverage had a negative effect on employment. Conversely, Greenwald and Stiglitz (1993) revealed that a firm's financial constraints negatively influence the demand for labour. Financial constraints are obstacles hindering new investment in firms that create jobs. (Acemoglu ,2001). There was a negative association between the employment level and the cost of capital measured in terms of the ratio of interest payments to cash flow (Nickell and Nicolitsas, 1999). Arnold (2012) showed the decline of employment for firms with financial constraints. Yazdanfar (2012) access to finance is important in obtaining financial resources and thereby hiring employees.

There are a good number of empirical studies on the determinants of job creation based on industrial organization and macroeconomic perspectives or on liquidity constraints. There is a limited prior research, however, on the effect of access to finance on job creation at the firm level. (Yazdanfar , 2012). In addition, there is limited study conducted to analyze the return on investment in terms of job creation. (Yazdanfar , 2012; Ayyagari, Demirguc-Kunt and Maksimovic, 2011; and World Bank, 2012). This initiates the need for this study to analyze the effect of MSE credit on job creation in the labor market. Previous studies had not typically investigated the impact of financial leverage on job creation. This study, however, deeply analyzes the effect of financial leverage on the job creation performance of MSEs in the labor market controlling for firm specific characteristics. Therefore, this study endeavors to add in empirical evidence perpetuating sound methodological contribution, filling existing empirical knowledge gap

1.4. Research Questions

1. What is the effect of firm size on job creation?
2. How does financial leverage affect job creation??
3. To what extent does firm age affect firm's job creation?
4. What is the effect of economic sector types on job creation?

1.5. Objective of the Study

Depending on the problem statement discussed above, the study has the following general and specific objectives.

1.5.1. General Objective

The general objective of this study is to determine the effect of credit and other firm characteristics (size, age and economic sector types) on the job creation performance of MSEs operating in Addis Ababa.

1.5.2. Specific Objectives

To attain the general objective of the study, the following specific objectives are considered:

- ❑ To examine the effect of firm size on job creation
- ❑ To analyze the effect of financial leverage on job creation
- ❑ To investigate the effect of firm age on job creation
- ❑ To evaluate the effect of firm's economic sector types on job creation

1.6. Research Hypotheses

The paper has a set of propositions tested. The propositions of interest were the following:

H₁: Firm size significantly affect job creation performance of MSEs

Ayyagari, et al., (2016); EFSE (2007) and World Bank, (2015) noted that firm size matters for job creation. EFSE (2007) confirmed that small businesses hire more people than micro businesses where as both Ayyagari, et al., (2016) and World Bank (2015) explained that medium businesses have created more jobs than the small ones. Heisz and LaRochelle-Côté (2004) stated that smaller firms tend to shed more labour than healthier firms for an equal sized drop in product demand. You and Fan (2019) in their empirical study of net job creation, firm size and firm age in china revealed that young enterprises (under the age of 5) are the major force in creating jobs. Yazandanfar (2015) confirmed that the firm characteristics of size influence the demand for labour by SMEs, and thus the creation of more jobs

H₂. Leverage significantly affect job creation performance of MSEs.

Gebreeyesus(2018) and Tarfasa et al. (2016) reveal the importance of firms access to finance for their performance including job growth, Seyoum et al., (2016) also demonstrated that MSEs with high investment had better potential growth than the not have. Ayyagari, et al.(2016) and World Bank (2015) also stated access to finance is key for MSE development and job creation. Carpenter and Petersen (2002) highlighted that most small firms' growth is constrained by access to internal finance, together with a small leverage effect affecting their employment performance. Heisz and LaRochelle-Côté (2004) underlines that a firm with high leverage sheds nearly 10% more employment than a firm with average leverage.

H₃. Firm age significantly affect job creation performance of MSEs.

Quite many empirical evidences such as Ayyagari et al., (2011) pointed out that SMEs are important job creators across different countries in the world. Haltiwanger, Jarmin and Miranda (2013) uncovered a strong role of MSEs in sustainable job creation in the US. World Bank, (2015) also demonstrated that MSE firms are foremost job creators in Ethiopia and financing constraints are the key business obstacles for job creation and growth. However, the employment or job creation potential of the SME mainly depends up on how better they are in terms of firm level education, experience, investment-initial capital stock and firm size. This is consistent with the findings of most other studies such as Gebreeyesus, (2018), Tarfasa et al., (2016) and Ayyagari, et al., (2016). Access to external financial resources has a positive effect on the growth of firms in terms of employees. (Yazdanfar, 2011)

H₄. A firm's economic sector types significantly affect job creation

EFSE (2007); (Yazdanfar, 2015) **and** Ayyagari, et al., (2016) all confirmed a positive association of industries with job creation. Yazdanfar (2015) found that a firm's industry sector has a positive and statistically significant influence on its job creation. The results also confirm that the firm characteristics of industry sector influence the demand for labour by SMEs, and thus the creation of more jobs.

1.7. Significance of the Study

The study will help financial institutions and policy makers (such as NBE, Job Creation Commission and Ministry of Finance) by giving insight how financial institutions better contribute to the job creation performance of MSEs through access to finance. The study contributes to the existing knowledge by showing the effects of access to finance on job creation. The results of the study will be used as a springboard for further research that provides empirical analysis on the contribution of financial leverage on job creation.

1.8. Scope of the study

This study was only conducted on the MSEs operating in Addis Ababa and therefore the results are merely applicable to the urban context. Moreover, the research was conceptually delimited to investigating the effect of financial leverage on job creation controlling for firm characteristics of size, age and sector. .

1.9. Limitation of the Study

The analysis of the study was mainly on the survey results. In addition, the study used cross sectional design, further studies can be done by using longitudinal design. The study focused on Micro and Small enterprises and did not include medium business. Therefore, other researchers can further extend the study to Micro, Small, Medium Enterprises (MSMEs).

1.10. Organization of the Paper

This research is organized in to five chapters. The first chapter primarily deals with introduction. Statement of the problem, objective of the study, delimitation, and significance of the study are addressed. Review of related literature including conceptual framework for the analysis is discussed in chapter two. Under this section relevant published and unpublished literatures, journals and other researcher's work that are previously carried out on similar areas are thoroughly reviewed in a manner to achieve the objective of the study and help the data analysis. Chapter three is about the methodology of the study. The analysis of data and model results is presented in Chapter four. The effect of MSE lending on job creation is analyzed in this chapter. Finally, in chapter five, summary of the findings, conclusion and recommendations are presented.

1.11. Definition of Basic Terms and Concepts

▣ MSMEs

There is no common definition for MSMEs in Ethiopia. For Micro and Small Enterprises, this study uses the definition of FEMSEDA⁴(see table 1 below) stipulated in the National MSE Development strategy issued in 2011. Accordingly, MSEs are defined by number of employees and capital with a slight differentiation in their economic sector. However, this definition does not specify the upper limit for medium businesses. To address this issue, the Medium Enterprises definition⁵ of the Development Bank of Ethiopia is used.

Table 1: Micro, Small and Medium-Sized Enterprises Classification

	Micro Enterprises		Small Enterprises		Medium Enterprises	
	Services	Industry	Services	Industry	Services	Industry
Economic sector						
Employees	≤ 5	≤ 5	6-30	6-30	31-100	31-100
Capital	< 50,000	<100,000	50,001-500,000	100,001-1,500,000	500,001-7,500,000	1,500,001-7,500,000

Source: adapted from FEMSEDA 2011 and DBE

The present study uses both the MSE Strategy and the DBE's guidelines to select samples from the 6 MFIs and applies the same in its analysis.

⁴ Federal Micro and Small Enterprises Development Agency

⁵ According to ADA and First Consult (2017) DBE defines Medium Enterprises with employees greater than 30 and less than 101

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1. Introduction

This chapter presents overview of Microfinance, MSEs in Ethiopia, the role of SMEs, theoretical framework and empirical literature overview for the study. The theory to be used in this study is Resource Dependency Theory (RDT), The study focuses on how this theory is applicable as theoretical ground on the role of MSEs in creating job opportunities.

2.2. Job creation

The study is based around resource based theory giving attention on firm level job creation. According to Conner & Prahalad (1996); and Wernerfelt (1984), resources refer to all types of assets including cash, debt capital, management capacity, networking, organizational processes, firm attributes, information and knowledge (Conner & Prahalad, 1996; Wernerfelt, 1984).

In order to achieve high level of performance in terms of sales, profitability and job creation, enterprises use various types of resources. The more firms have resources, the more investment expenditure they have and the demand for labor. Financial resources are transformed into other resources resulting in increased growth higher profitability, larger market share and higher employment.

The availability of financial resources allow enterprises to grow in terms of technology, acquiring labour and entering new markets (Castrogiovanni, 1996).

The new-Keynesian perspective states that market imperfections, which is caused by information asymmetries, agency costs, moral hazards and adjustment costs, in a way explain the access to financial resources and thereby their demand for labour (Arnold, 2002; Greenwald & Stiglitz, 1993). Financial difficulties affect employment (Benito & Hernando, 2002; Bond & Meghir, 1994; Bond & Van Reenen, 2007; Cantor 1990; Nickell & Nicolitsas 1999; Sharpe 1994).

According to Modigliani & Miller (1958), there is no relationship between an enterprise's financial structure and its value which implies that a firm's financing choice has no effect on its real operation.

Nevertheless, market imperfections⁶ lead to the separation of investment and financing decisions. Small enterprises face more financial constraints than larger firms as a result of market imperfections (Myers, 1984; Myers & Majluf, 1984; Oliveira & Fortunato, 2006).

Financial resources are critical for vulnerable firms that is start up micro and small businesses (Myers, 1984; Myers & Majluf, 1984).

According to the resource-based approach, larger firms achieve the economies of scale, and suffer less from information asymmetries, moral hazards, financial distress, cash flow volatility and bankruptcy risk. Therefore, they have better debt capacity. They have better loan access with better conditions and so they are more likely to suffer less from financial constraints and thereby have better opportunities to employ labour. In addition, Likewise, older firms will have considerably more resources in terms of knowledge, networks, markets and communications than younger firms, since older firms acquire resources over time (Autio, 2005; Jovanovic, 1982).

In addition, age is negatively related with information asymmetry. This implies that older firms have better access to external finance compared with young firms.

Young enterprises do not have credit history and track record. As a result, they face more information asymmetry problems in acquiring loans. Age is positively associated with access to debt capital, liquidity and job creation (Audretsch, 1995; Broersma & Gautier, 1997; Oliveira & Fortunato, 2006). Financial constraints in terms of low debt capacity and limited access to liquidity are regarded as one of the most important barriers to employment (Yazdanfar, 2011). The association between firm financial constraints and investment, growth and employment has been highlighted by previous research (Acemoglu, 2001; Oliveira & Fortunato, 2006).

⁶ asymmetric information problems, moral hazards, agency conflicts between shareholders and managers, labour market regulations, and distortionary taxation

2.3. Theoretical Literature

2.3.1. Relevant Theories

2.3.1.1. Resource Dependency Theory

The theoretical ground of Resource Dependency Theory is used to support availability of resource (finance) variable. In comparison to large enterprises, micro and small enterprises (MSEs) are typically regarded as resource-constrained, lacking financial and other resources, market power, knowledge to operate effectively in the markets (Knight 2000). The vulnerability of an organization to its environment comes from its need for resources: materials, human resources, capital, equipment, knowledge and markets for its products/services, etc. However, these resources are controlled by the organization's environment, which gives it power.

Resource dependence theory (Pfeffer and Salancik, 2003) posits that organizational behavior is affected by the management of its dependence on external resources. From the perspective of resource dependence theory, organizations are self-constrained with regard to possess the needed resources for value creation. Consequently, organizations need to establish interdependencies for interacting each other and get access to resources to increase survival rate.

Resource dependency theory focuses on the firm's ability to establish relationships to access resources (Van-Witteloostuijn and Boone 2006). Resource dependency theory assumes that the organization makes active choices to achieve objectives. A major tenet of resource dependency theory is resource scarcity, resulting in multiple organizations competing for the same or similar sets of scarce resources (Barney and Arian,2001). According to resource dependency theory, firms are dependent upon other actors in the immediate "task environment" to obtain resources. To survive, firms need to obtain resources from (actors in) the external environment. The focal organization will act to reduce or increase its level of reliance on those actors, through actions such as alliances or joint ventures (Kotabe, 1992).

The theory of resource dependency notices a bidirectional relationship between businesses and the environment (Pfeffer, 1978). The theory puts in evidence the need to adapt to the uncertainty of the environment and to address the problems of SMEs interdependencies and control of resource flows in two ways (Tian et.al., 2009).

Sudolska (2014) argue that the management of dependence against the resources required not only identifying and carefully monitoring the environment but also imagining solutions to rebalance the enterprise's power relative to other partners when the situation becomes unfavorable. Resource Dependency Theory (RDT) proposes that actors lacking essential resources will seek to establish relationships with others in order to obtain needed resources. Also, organizations attempt to alter their dependence relationships by minimizing their own dependence or by increasing the dependence of other organizations on them (Pfeffer, 1981). Acquiring the external resources needed by an organization comes by decreasing the organization's dependence on others and/or by increasing other's dependency on it, that is, modifying an organization's power with other organizations.

The theory argues that organizations depend on resources, these resources ultimately originate from an organization's environment, the environment, to a considerable extent, contains other organizations, the resources one organization needs are thus often in the hand of other organizations, resources are a basis of power, legally independent organizations can (Pfeffer, 1978).

The resources (particularly Financial Resources) of SMEs emanate from external environment/actors (ex: banks and microfinance). These financial institutions are key in ensuring the success of SMEs in job creation and growth of the enterprise. The proper utilization of the resources by SME owners most of whom are not informed and with limited management skills, tend to misuse them. The researcher argues that Financial Resource Mobilization and management practices therefore make SMEs in a better position to create employment opportunities. In this respect, Resource dependency theory can also be applied to consider a firm's need to obtain resources required for growth in firm's size (mostly measured in terms of number of employees). MSEs often depend on their external environments for obtaining the finance needed for growth and expansion and SMEs will benefit when these resources are perceived to be widely available and easily accessible.

2.3.1.2. Labour Economics Theories

Labour economics explains the function and dynamics of markets for labour as it is a commodity supplied by labourers in exchange for a wage paid by the demanding firms. Labour or job markets function via the interaction of employees and employers. Labour economics analyzes the suppliers of labour services (employees) and the demanders of labour services (employers) and the pattern of wage, employment and income.

For the purpose of these studies, the labor economics theories of the neo-classical, Keynesian and real investment led economy are considered

A. Neoclassical theory of the firm

A firm's labour demand is based on its marginal physical product of labour (i.e. the additional output that results from an increase of one unit of labour). Labour demand is a derived demand in a sense that hiring labour is not desired for its own sake. Instead, it is needed in producing output contributing to an employer's revenue and profits. (Purvis, 1976) The demand for an additional unit of labour depends on the Marginal Revenue Product (MRP) and the marginal cost of the employee. In a perfectly competitive goods market, the MRP is calculated by multiplying the price of the end product or service by the Marginal Physical Product of the employee. When the MRP is greater than a firm's Marginal Cost, then the enterprise will employ the worker as this will increase profit. It is to be noted that the firm will only hire up to the point where MRP equals MC in neoclassical economic theory. (Robert, 2006)

MRP is affected by the amount of physical capital. The amount of physical capital available is determined by the financial capital flows. Therefore, MRP is dependent of the financial capital (Scott, 2000). According to neoclassical theory, the marginal physical product of labour reduces over the relevant range of outputs (i.e. law of diminishing returns). In other words, the additional output starts to decline as more and more units of labour are employed,

Neo classical theory of the firm suggests firms grow until they reach the size corresponding to minimum cost as they lack incentive to grow beyond this size (Trau ,1996). The supply and demand curves can be analyzed in the same way as any other industry demand and supply curves to determine equilibrium wage and employment levels.

B. Keynesian and monetarist theories

Modern interest in labor theory was triggered by the Great Depression of the 1930s in the United States and Europe. The classical economics lacked solution for the problem of that era due to its failure to explain the stubbornly high levels of unemployment. In his publication of *General Theory of Employment, Interest and Money (1936)*, John Maynard Keynes came up with new thinking on employment theory. Keynesians expanding on his theory have focused on the relationship between income, output and expenditure. Transactions are two sided as one person's income is another person's expenditure. Effective demand is equal to income as well as to output. Consumers can either spend or save their income (Pierangelo, 1979).

Keynesians are of the opinion that economic instability stems from the discrepancy between savings and investment. When savings increase compared with previous levels, the effect will be a reduction in current demand with a rise in future demand. If investment rises by the same amount, productive resources will continue to operate at capacity; there will be no change in the level of activity, and the economy will remain in equilibrium. Conversely, if investment does not increase, then demand for labour will fall and workers could be unemployed losing their income.

Keynes's argued that government spending could be increased when businesses fail to increase investment because of demand so as to pull the economy pull out of disequilibrium. Keynesians consider an increase in government expenditure or a reduction in taxation as the effective way to address the issue of lack of private demand.

A related theory of employment is the monetarist theory where the quantity of money (i.e. increasing or decreasing money supply) has a controlling role. Monetarist like Milton Friedman advocated monetary policy as the proper tool of government (Friedman and Schwartz, 1963). Both the Keynesian and the monetarist theories are demand side theories.

Keynes perspective is close to investment led economy viewpoint. Keynes's analysis recognized that the power is in the hands of producers. This is mainly due to the fact that firms decide how much employment to offer on the basis of their expectations (Chick, 2007). A firm is an initiator and the quantity of employment depends on the totality of investment.

C. Real investment led economy view

According to the real investment led economy view, firms invest when anticipated gains exceeds the expectation of the necessary costs by the level that generates a satisfactory return on capital. The types and quantities of jobs flow depends on the level of investment. The costs of the investment are justifiable in view of the expectation of better performance in the medium and longer term. Innovative investment may be needed to cope up with competition in a dynamic sector. Business closure affects firms that are relatively in a weak position. Firm's profitability is crucial to hire employees. Weak demand could lead to inclination of firms to reduce costs in the short term. This usually brings loss of jobs or loss of appetite to create more jobs. (Joffee, 2018)

The firm centered view in this situation is a reflection of investment. A firm in a weak position shall change the focus area to operation scale probably downsizing to minimize losses. This may include cut wages or layoffs.

According to Bewley (1999), firms make decision in light of their economic environment. At the core of labor economics probably is the existence of unemployment. The real investment led economy viewpoint argue that the emphasis should be on the opportunities for enterprises to make investments so as to be profitable and hence create jobs (Bewley, 1999).

2.4. Empirical Literature

2.4.1. MSEs and job creation

Empirical literature that supports micro and small businesses create a good number of jobs in developing economies (World Bank, 2013). Various researches (including Birch, 1979; Meller, 1981; Kirchoff and Phillips, 1988; Haltiwanger, Jarmin, and Miranda, 2010; .Haltiwanger, Jarmin and Miranda ,2011) are increasingly providing empirical evidence on the association and linkages of MSEs and jobs creation over time SMEs have usually been perceived as the dynamic force for sustained economic growth and job creation in developing countries (Nega and Seid, 2016).

The activities of the SME sector in Africa are crucial for promoting economic growth, job creation and poverty alleviation (Rogerson, 2001:267). Steyn and Leonard (2012:24) even see SMEs as the driving force of any economy. Small- and medium-sized entities constitute a vast

section of the private sector in the majority of developed and developing countries (Beck &Demirguc-Kunt 2006).

From a global perspective, Stouraitis, Harun and Kyritsis (2017) cited Gerlach-Kristen, O'Connell and O'Toole (2015) indicating that SMEs contributed towards 50% of the global GDP and 60% of global employment.

After a review of 50 empirical studies focusing on the job creation of SMEs in developing countries, Deijl, De-Kok and Veldhuis-Van (2013) concluded that SMEs created two-thirds and 80% of all formal jobs in emerging and low-income economies, respectively. The above stated figures are a testimony to the important role that SMEs continue to play across the globe towards economic stability and development (Sinbanda, 2018). SME finance can positively affect several firm performance indicators, dependent on the program and firm type (Renate, 2017)

According to the GTP II (2016), based on the small and micro enterprises development strategy, supporting frameworks and implementation strategies intensive work will be undertaken to organize Small and micro enterprises (SMEs) operators and support them to start, expand business and hire more jobs. Thus, availing adequate (finance) credit, creating market linkages/ networks and creating conducive climate for business activities will be carried out in order to make these business operators profitable through enhancing their competitiveness in price, quality and quantity (GTP II, 2016).

2.4.2. Firm size and job creation

Overall debate about the relationship between firm size and job creation comparing large and small businesses, and in particular whether small firms play a more important role in job creation than large ones, has been going on for a long time. The most influential work in the initiation of this debate were the studies by Birch (1979, 1981, 1987) which argued that it is the small firms that were the most important engines of job creation.

When it comes to MSEs , many researches agree that firm size matters for job creation of MSEs.their findings indicated a mixed result on the association of firm size and job creation. Facet (2007); World Bank (2015) and Ayyagari, et el, (2016) stated that when firm size increases, firms will create more jobs. World Bank (2015) showed medium businesses hire more

people than small enterprises. EFSE(2007) similarly showed small create more jobs than the micro ones.

Yazandanfar (2015) confirmed that that the firm characteristics of size influence the demand for labour by SMEs, and thus the creation of more jobs

According to Renate et al., (2017), firms should be sufficiently large and experienced to use the finance effectively. The effect of SME finance on firm performance including job creation increases with firm size, as larger firms may be less financially constrained. There may be some kind of optimum size of firms for which SME finance leads to a highly significant improvement in performance including job creation (Renate et al., 2017).

Haltiwanger, Jarmin and Miranda (2011) used data from the Census Bureau Business Dynamics Statistics and Longitudinal Business Database to explore the many issues regarding the role of firm size and growth that have been at the core of this ongoing debate (such as the role of regression to the mean). They find that the relationship between firm size and employment growth is sensitive to these issues (Nasr and Rostom, 2013).

2.4.3. Access to finance and job creation

Lack of financing availability for SMEs not only hinders new business establishment but also hampers the economic growth of countries because of fewer jobs (Rahman, et al., 2017).

Ayyagari, et al.(2016) and World Bank (2015) stated access to finance is key for MSE development and job creation. Carpenter and Petersen (2002) highlighted that most small firms' growth is constrained by access to internal finance, together with a small leverage effect affecting their employment performance. Heisz and LaRochelle-Côté (2004) underlines that a firm with high leverage sheds nearly 10% more employment than a firm with average leverage

Beck and Demirguc-Kunt (2006) stated that SMEs are financially more constrained than large firms and are less likely to have access to formal finance. (Beck and Demirguc-Kunt ,2006)

Bhaird and Lucey (2009) propose on the basis of pecking order theory, that as firms grow, they accumulate earnings and can use these to finance themselves instead of using external sources. Large firms on the other hand, have less volatile cash flow and are generally less risky, which

makes them more attractive for a lender (Abor and Biekpe, 2009). The tradeoff theory therefore predicts firm size to be positively related to external debt use (Eriksson, 2015).for growth impacting its capacity to create jobs. (Yazdanfar, 2015)

According to Ericsson (2015), in Ethiopia, despite the introduction of banking sector reform in 1994 that led to expansion of the banking industry, SMEs' problem of credit access has persisted implying that changes in the banking sector structure *per se* are not sufficient to introduce competition in the banking industry and an improvement in SME credit access (Eriksson, 2015;Ashenafi, 2012).

Limited access to finance is one of the leading factors contributing to the unimpressive growth and performance of enterprises including job creation (Wolday and Gebrehiwot, 2004). According to the World Bank (2015), Ethiopia is lagging behind other Sub-Saharan Africa's countries and developing countries in terms of lending to SMEs.The share of SME lending in overall lending portfolio in Ethiopia is in fact only 7 percent, among the smallest shares in Sub-Saharan African countries as well as far below that of developing economies (World Bank, 2015).

The EDRI survey (2018) highlighted that of the enterprises that had access to loans, not surprisingly, Micro FinanceInstitutions (MFIs) seem to be the main source for both investment and working capital. Two-thirds of these enterprises reported having loan access from MFIs, and only about 15% from formal banks. In this regard, we find a clear difference between the size classes (EDRI, 2018).

According to economic development plan-GTP II, GoE addressed financing plan to MSMEs. A total of ETB ETB 21 billion is planned to be available and ready for credit financing and 94% (ETB 19 billion) of the is expected to be repaid during the plan period(NPC, 2016).

2.4.4. Firm age and job creation

There is a mixed finding regarding the influence of firm age on job creation performance of MSE. You and Fan(2019) in their empirical study of net job creation, firm size and firm age in china revealed that young enterprises (under the age of 5) are the major force in creating jobs. Simliarly, Haltiwanger, Jarmin, and Miranda (2013) found that startups create the majority of

new jobs in the American economy (Haltiwanger, Jarmin, and Miranda (2013) The research suggests that startups and surviving young businesses are critical for job creation. Likewise, young firms were responsible for almost all net job creation in the economy (Haltiwanger et al. 2009, 2013, StaStangler and Litan 2009). On the contrary, other researches such as Facet (2007) and Yazandanfar (2015) argue that when firm age increase the performance of MSEs improve to create more jobs.

2.4.5. Economic sector types and job creation of MSEs

Prior researches have indicated the relationship between economic sector and job creation. (EFSE, 2007; Yazandanfar, 2015; and Ayyagari, et al., 2016). For instance, Yazandanfar (2015) found that a firm's industry sector has a positive and statistically significant influence on its job creation. The results also confirm that the firm characteristics of industry sector influence the demand for labour by SMEs, and thus the creation of more jobs.

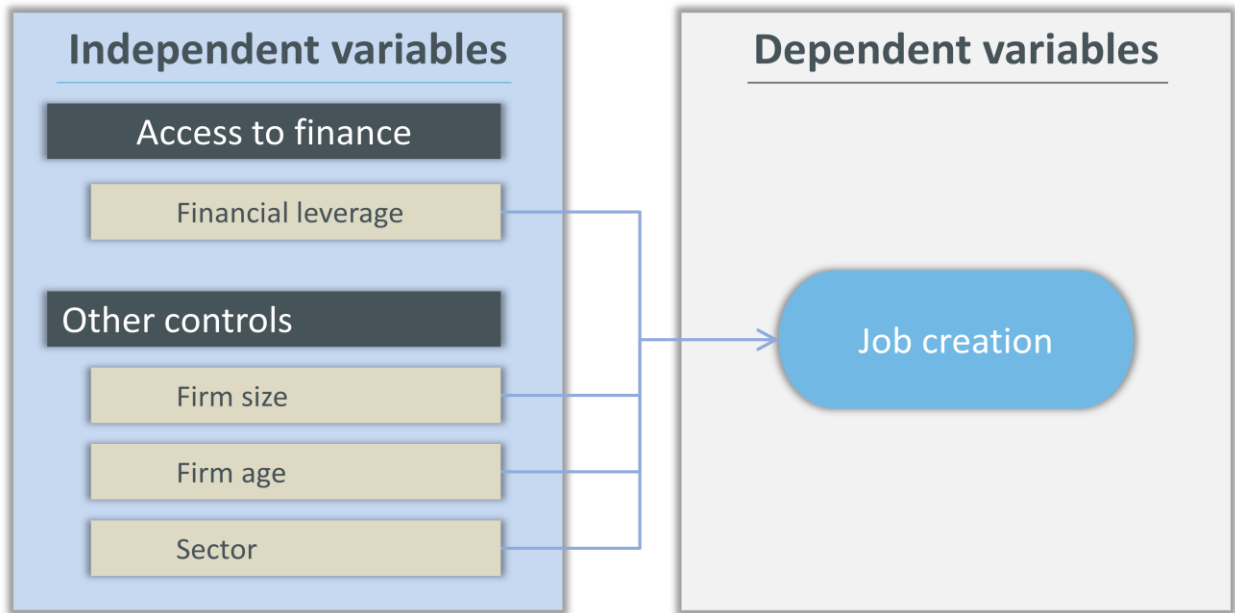
According to the World Bank (2015), the manufacturing sector plays a limited role in the overall Ethiopian economy, comprising only 4.2 percent of GDP in 2012/13. Therefore, it's important to also understand employment trends in the services sector. The service sector created nine times more jobs than the manufacturing sector during the period 2009-2011.

The government believes that the 5 priority sectors (manufacturing, construction, urban agriculture, trade and service) play a crucial role in promoting entrepreneurship, creating jobs and laying the foundation for industrial development. (ADA, 2017).

2.4. Conceptual Framework

Figure 1, elaborates the basic frameworks of the research. The area of interest of the research is to show the effect of access to finance on job creation. Financial leverage measures access to finance. Financial leverage representing access to finance is the independent variable. Lack of access to finance is a bottleneck that hampers the growth and job creation contribution of MSEs. Other control variables are firm characteristics which includes firm size, enterprise age and economic sector. These firm level characteristics also matter when MSEs endeavor to flourish and create jobs. In light of the careful review of the literature, the following conceptual framework is developed adopting Yazandanfar (2012).

Figure 1: Conceptual Model



Source: adopted from Yazdanfar (2012)

CHAPTER THREE

RESEARCH METHODOLOGY AND DESIGN

3.1. Introduction

This chapter describes how the study was conducted. It focuses on the research design and approaches that are adopted, the study area, target population, sampled population, sample size and selection. The chapter mainly consists of data collection instruments, sampling techniques and procedures, pre-testing of instruments, methods and procedures for data collection and analysis.

3.2. Research approach

The study was conducted on the basis of mixed research approach comprising of quantitative and qualitative data. Quantitative approach allowed to solicit information that are quantified, while the qualitative approach is employed to solicit information that could not be quantified as observed by Mugenda and Mugenda (1999). Thus, quantitative research approach including descriptive and inferential statistics was necessarily applied in due course. The qualitative method described variables that could not be measured in quantitative terms. Combining numerical and textual information helped to have an in-depth analysis of the subject matter.

3.3. Research Design

This study is more of explanatory type in nature. It is having explanatory nature from the perspective of elaborating the effect of access to finance (measured by financial leverage) on job creation through the inferential statistical approach. Descriptive analysis is also used to describe the characteristics of the data and produce meaningful analysis of the data and make conclusions

3.4. Sources and Data Gathering Techniques

The research was conducted mainly based primary data. The primary data were collected through self-administered open and close ended questionnaires to 206 MSEs in Addis Ababa. The secondary sources of data were from various reports of National Bank of Ethiopia and AEMFI, Federal Small and Medium Manufacturing Industry Development Agency (FSMMIDA) and Federal Urban Job Creation and Food Security (FUJCFSA), and the World Bank..

3.5. Target Population and Sample Size

The study was conducted in Addis Ababa. The research location is selected mainly because of the high prevalence of the research problem in relation to the rising trend of MSEs along with the high level of need for financing. In cognizant of the numerous MSEs operating in Ethiopia, it would be exhaustive for the study if there will be a chance of accommodating all the MSEs in Addis Ababa; however, the researcher is required to delimit the study to incorporate 206 MSEs so as to analyze the research problem in detail.

3.5.1. Kothari's Sample Size Formula

The study used the Kothari (2004) formula which allows to calculate an ideal sample size given a desired level of precision, desired confidence level and the estimated attribute present in the population. Kothari's formula is considered especially appropriate in situation with large populations. The Kothari formula is represented as:

$$n = \frac{z^2 \cdot p \cdot q \cdot N}{e^2 (N - 1) + z^2 \cdot p \cdot q}$$

Where

- $z = 1.96$ (desired confidence level is 95% and value obtained from table)
- e is the desired level of precision (i.e. the margin of error),
- p is the (estimated) proportion of the population which has the attribute in question,
- q is $1 - p$.
- n is size of sample

According to the World Bank (2015), only 1.9% small firms and 6% of micro firms have a loan or a line of credit. If we take the average, the success rate (p) would be 4%. At 95% desired confidence, the value obtained from table shows z is 1.96. Researches indicate a total of 18,654 micro and small enterprises operate in Addis Ababa in the year 2014, recent available data. (FEMSEDA, 2014). The percentage increases in the number of borrowers of MFIs on average was 20% in 2015, 22% in 2016 and 1% in 2017. (Alemu and Hassen, 2018). When the growth rates are applied, the number of MSEs operating in Addis Ababa will increase to 27,583. Within the 3% margin of error:

$$n = \frac{z^2 \cdot p \cdot q \cdot N}{e^2 (N - 1) + z^2 \cdot p \cdot q}$$

$$n = \frac{(1.96)^2 * (0.04) * (1 - 0.04) * (27583)}{0.03^2(27583 - 1) + (1.96)^2 * (0.04) * (1 - 0.04)}$$

$$n = \frac{4068.97}{24.8238 + 0.1475} = 163$$

Considering a 25% non-response rate of the survey questionnaire, the total sample was determined to be 206 MSE firms.

3.5.2. Sampling Techniques

After the sample size is drawn based on the above formula, convenience sampling technique was used to select the MSEs. Accordingly, the sample 206 MSEs that are operating in Addis Ababa were selected.

3.6. Methods of data collection

The primary data were collected using structured questionnaire which was adapted from EFSE(2007) and Yazdanfar (2011) with adaptation to the context of the study. In order to collect quality data, a team of enumerators with 6 people were used. A classroom training followed by onsite coaching was provided to the data collection team to help them understand the content of the questionnaire. The training included "how to ask the right question" sessions so as to equip them the techniques to collect quality data at the required level. The training sessions were also used to test the questionnaire, collect feedback and produce the final versions.

3.7. Data Analysis and Interpretation

Upon completion of the research data generation, the statistical software STATA version 20 was used to process and analyze the data. Careful and comprehensive data entry and cleaning was carried out as good analysis rests with good data entry and encoding. The various types of statistical analysis were used. This basically includes both qualitative and quantitative data

analysis and interpretation. The quantitative data was analyzed using both descriptive and inferential statistics. On top of this, the t-test, and Chi-square statistics were employed to analyze the mean differences of financial situation of the target groups of MSEs. In order to show the cause and effect relationship between various explanatory factors affecting the MSEs, regression models were used.

3.8. Model specification: Ordinary Least Squares

This study seeks to examine the effects of access to finance on job creation using an OLS model. To correctly specify the model, the firm level characteristics are included as other control variables. The number of current jobs is the dependent variable measuring job creation. Financial leverage (measuring access to finance) is the explanatory variables based on previous researches. Such researches include Carpenter and Petersen, 2002; Heisz and LaRochelle-Côté, 2004; Lang et al.,1996; Yazdanfar, 2011. Financial leverage is referred to as MSE's total liabilities divided by total assets.

The control variables are firm characteristics of size, age and economic sector selected based on based on the findings of previous researches which showed a link with job creation. Various researches (Broersma and Gautier, 1997; Hall, 1987; Oliveira and Fortunato, 2006; and EFSE, 2007) confirmed the relationship between job creation and firm size. For instance EFSE (2007) articulated that small businesses create more jobs than micro enterprises.

As evidenced by the researches of Audretsch(1995),Broersma and Gautier (1997), and You and Fan (2019), age is another firm characteristics which has association with job creation. Finally, economic sector is also considered as a firm level factor influencing job creation based on the research works of Al-Haddad (2019),Yazdanfar (2015) and EFSE (2007).

In line with the national definition, firm size is measured as the value total capital of firms (FEMSEDA, 2011). Firm age is measured by the number of years between the firm's establishment year and the year of data collection. A categorical variable is used for economic sector.

In line with the theoretical regression model (Gujarati, 2004), OLS model is shown below in equation 1

$$Y_i = \alpha_0 + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 \dots \dots \dots + \beta_n x_n + \dots \varepsilon \quad (1)$$

Where $y \sim$ refers to the response variable, $\alpha \sim$ intercept of the function, and $\beta_1, \beta_2, \beta_3, \beta_4$ and β_n refers to the coefficients of the explanatory variables. The disturbance, or error term, is represented by ε

For this study, the model of Yazdanfar (2015) is adopted:

$$\mathbf{Job}_i = \alpha_i + \beta_1 \mathbf{Size}_i + \beta_2 \mathbf{Lev}_i + \beta_3 \mathbf{Age}_i + \beta_3 \mathbf{Sector}_i \dots + \beta_n x_n + \dots u_i \quad (2)$$

Adopted from Yazdanfar (2015)

α_i = constant

\mathbf{Job}_i = is the natural logarithm of the number of employees in the current year

\mathbf{Size}_i = size of firm i ; is measured as the value of total capital of the firm

\mathbf{LEV}_i = financial leverage ratio between total liabilities and total asset

\mathbf{Age}_i = age of firm i at time; age is the number of years since the firm's inception as of the year of data collection

\mathbf{Sector}_i = the categorical variable, economic sector

u_i = error term

The main objectives of the study is estimating the effect of financial leverage on job creation. Having obtained the appropriate measures of access to finance, it is important to control for general business conditions, firm characteristics, and firm level controls. Thus, the MSE survey contains important data on firm characteristics and these include information on firm size, age, and sector. This is an important feature of the data which affords the researcher the opportunity to examine if and how these characteristics differ across, and affect differently, different types of firms.

3.9. Description of Variables and their proxies

S.N	Variable	Description	Type of variable	Expected sign
Dependent variable				
1	Job creation	Current number of employees		
Independent variables				
1	Financial leverage	Financial leverage ratio (debt to asset ratio)	Area of interest for the study representing access to finance	(+)
2	Firm size	Value of capital in line with National definition (see table 1)	Control	(+)
3	Firm age	The number of years of the firm since establishment t	Control	+/-
4	Sector	Refers to economic sector of firms with ategorical variables consisting Manufacturing, Trade, service, construction, and urban agriculture,	Control	+

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1. Introduction

This chapter presents data collected through questionnaire and the analysis made based on the appropriate methods. The responses are presented and analyzed to address the questions raised in the study and to meet objectives of the study. Hence, the representative sample size for this study was 206 respondents, which are the owners of MSEs selected for the study.

4.2. Data Cleaning and Response Rate

A team of 6 enumerators was organized to collect the data from MSE owners and managers. Training is provided to the team to enable them fully understand the questionnaire and use techniques to get the best from the respondents. The questionnaire is tested on MSEs with onsite coaching of the team by the researcher. Adaptation was made to the questionnaire based on the result of the testing. On top of this, proactive monitoring was done by the researcher throughout the data collection process. MFIs were also engaged in the data collection process as they were sharing MSE list and some branch staff were also cooperating during the collection process. Well designed questionnaire, training to enumerators, questionnaire testing and adaptation, MFI support, proactive supervision by researcher all contributed to the 100% response rate.

Table 2: Data Clearing and Response Rate

Description	Response Frequency
Sample selected	206
Questionnaires provided to enumerators	206
Questionnaires used by enumerators	206
Valid questionnaires	206
Response rate	100%

Source: Survey result, 2020

4.3. Descriptive statistics

4.3.1. Firm Characteristics

A total of 206 MSEs are surveyed. The number of employees of the surveyed employees ranges from 1 to 30. This shows that all interviewed MSEs fall within the National definition of MSEs (FEMSEDA, 2011). Firm size of MSEs indicate that the minimum capital of the surveyed MSEs is 18 thousand where as the maximum capital reaches 800thousand. The leverage ratios ranges from not leveraged to highly leveraged firms with an average leverage ratio of 0.23:1.

Table 3: Summary of descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
emp current	206	7.641	7.403	1	30
Size	206	163289.78	146881.07	18181.818	800000
Lev	206	.263	.215	0	.73
firm age	206	7.67	7.381	1	30
Sector	206			1	5

Source: Survey result, 2020

Young to old firms are included in the survey. Five economic sectors were captured in the survey. Economic sector is a categorical variable where 1 is manufacturing, 2 is trade, 3 is services, 4 is construction and 5 urban agriculture.

4.3.1.1. Firm⁷age and firm size

The distribution of the MSEs by age (number of years in operation) at the time of the survey is depicted in the following table.

Table 4: Firm age and firm size

Firm_size	mean	sd
Micro	2.83	1.29
Small	12.9	7.68
MSEs	7.6	7.3

Source: Survey result, 2020

⁷ MSE enterprise and firm are interchangeably used though there might be some differences in different contexts.

The average firm age of MSEs is 7.6 years. Micro businesses operated for 3 years. Small enterprises have been in businesses on average for 12 years. Here one can infer firm age increases with size of enterprises. The standard deviation shows that firm age, have less variation. The deviation of firm age increases when firm size increases.

4.3.1.2. Economic sector and firm size

The sector distribution of MSEs shows that services took the lion share with 60% followed by trade and manufacturing with 18%.

Table 5: Economic sector and firm size

Business sector	Size of the Firm		
	Micro	Small Scale	Total
Manufacturing	14	22	36
Trade	22	12	34
Services	58	61	119
Construction	2	3	5
Urban Agriculture	3	1	4
Total	99	99	198

Source: Survey result, 2020

The concentration of MSEs in service and trade is the result of the convenience sampling and it reflects the structure of the economy and the MSE loan portfolios of MFIs. The segregation of data by firm size shows that manufacturing takes the second spot for small enterprises where as it is still trade for micro businesses.

4.3.2. Financial leverage

All MSEs included in the sample are clients of MFIs. Their average leverage ratio is 0.2:1. Micro business are less leverage compared with small firms. This could be related to the relative economies of scale to expand business to attract external finance when firm size increases.

Table 6: Financial leverage

Firm_size	mean	sd
Micro	.117	.148
Small Scale	.421	.159

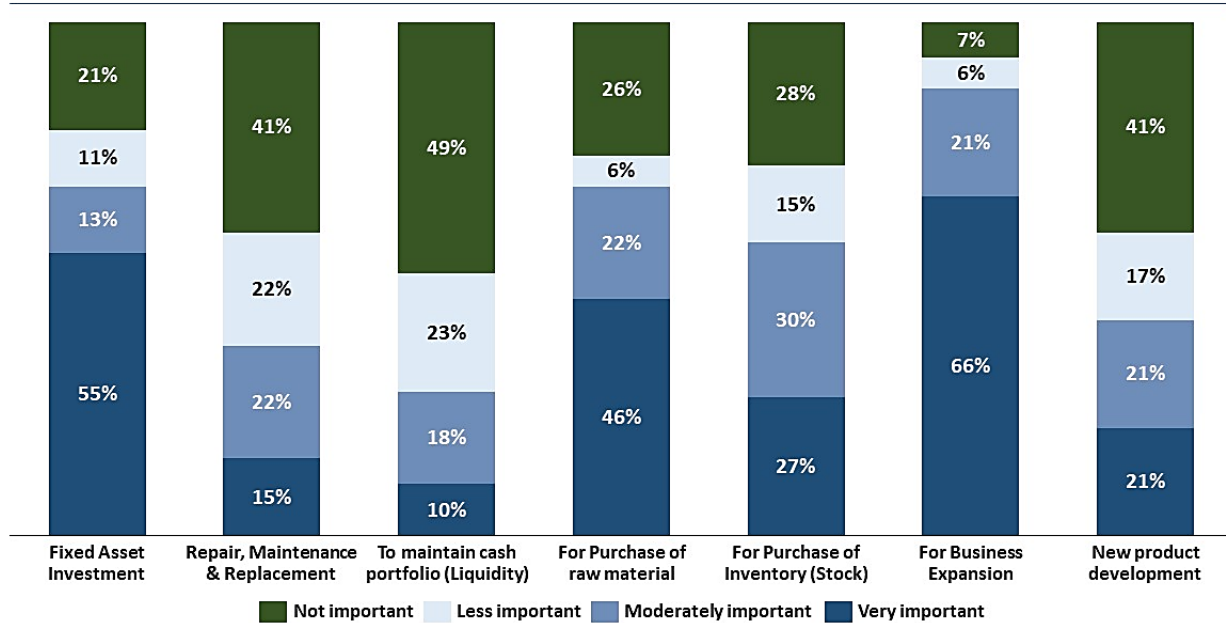
Source: Survey result, 2020

The need for financial leverage (access to finance)

According to figure 2 below, business expansion or working capital loan, fixed asset investment and purchase of raw material are the major purposes of the loan for MSEs.

Figure 2: Respondents' Rate of the Purpose of financial leverage by the Degree of Their Importance

Respondents' Rate of the Purpose of Loan by the Degree of Their Importance



Source: Survey result, 2020

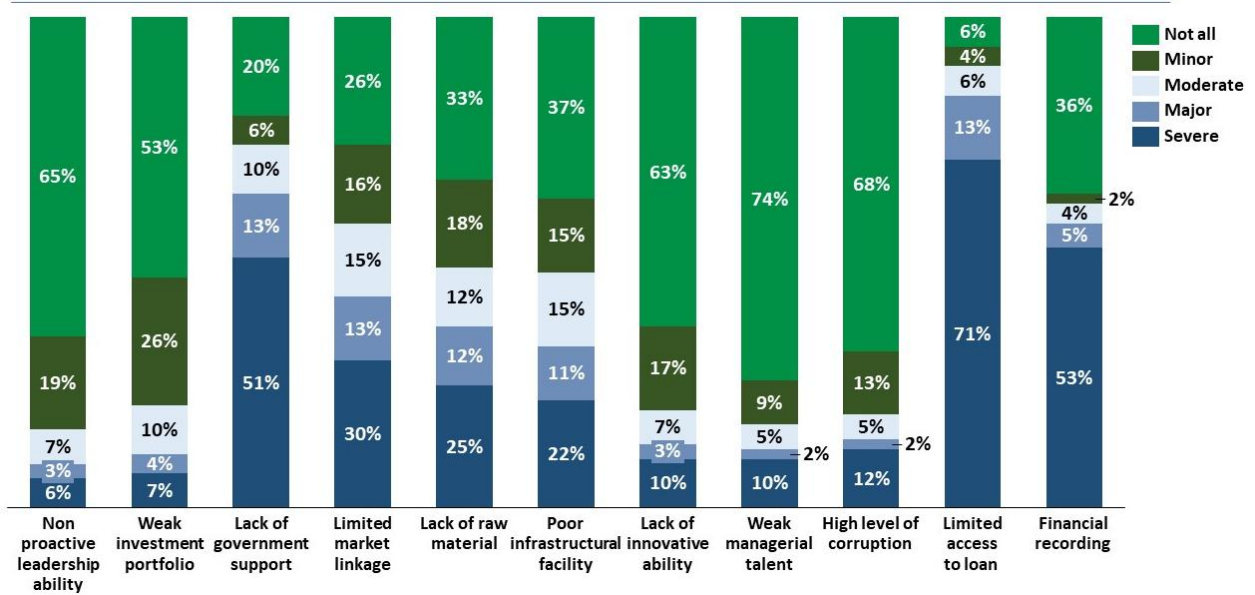
This shows that MSEs are highly in need of external finance to address daily operations financial difficulties including wage payments to employees.

Financial leverage: the major constraint of MSEs and job creation

Limited access to loan, financial recording and lack of government support, are the severe problems affecting the performance of MSEs including job creation. This implies that access to finance is the major bottleneck of MSEs more than any other business constraints. Many other similar studies such as World Bank (2015), Tarfasa et al.(2016) Ayyagari et al.(2016) and (Sisay 2019) have demonstrated that the problem of access to finance severely retarding the growth and development MSEs including their job creation capacities.

Figure 3: Financial leverage: the major constraint of MSEs and job creation

Problems and Constraints Affecting Firm's Business Performance



Source: Survey result, 2020

4.3.3. Descriptive statistics of job creation

4.3.3.1. Initial and current employees

The average number of employees at the establishment of businesses was 2 for micro and 4 for small enterprises. Presently, this is increased to 3 employees for micro and 13 for small enterprises.

Table 7: Average employment by firm size

	Micro		Small Scale	
	mean	sd	mean	sd
Employee initial	2	2	4	5
Employee current	3	1	13	8

Source: Survey result, 2020

This indicates that employment growth is correlated with firm size as the growth is better with small compared with micro businesses

4.3.3.2. Financial leverage and job creation

The average loan amount of surveyed enterprises is birr 42k for micro and 284k for small businesses. Number of initial employees was 2 for micro which was increased by 1 employee. Current employees increased to 13 employees from their position of 4 employees at the time of establishment..

Table 8: Average loan amount and job creation

	Micro		Small	
	mean	sd	mean	sd
emp initial	2	2	4	5
emp current	3	1	13	8
avglamt	42185	48798	283776	145695

Source: Survey result, 2020

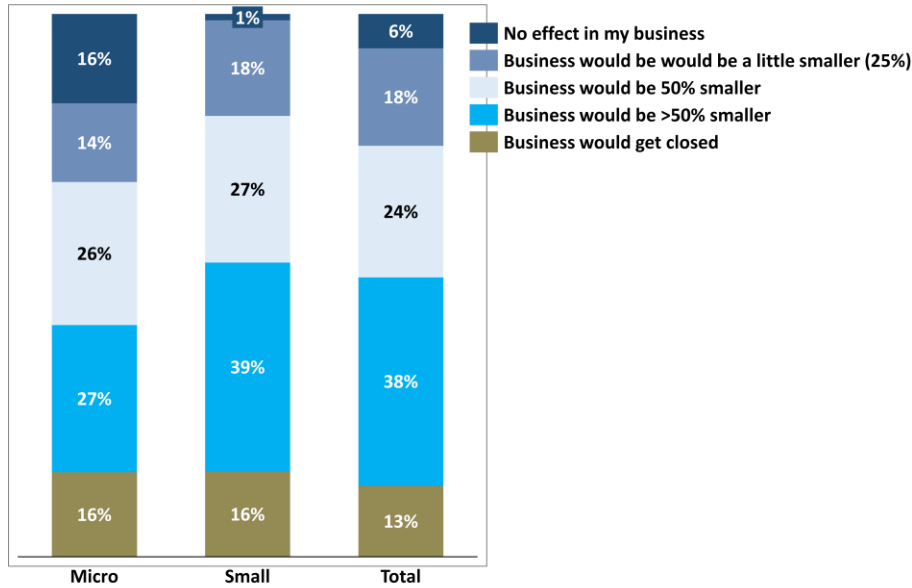
Although the employee change includes equity contribution, one can note that loan size increases with firm size. The bigger the better as far as employment is concerned

4.3.3.3. The contribution of financial leverage on MSE performance including job creation

Businesses were enquired to imagine "what would be the effect of not getting such loans". 38% indicated the business would be a lot smaller (>50%) and 18% the business would be a little smaller (<50%) and 18% said it would be 25% smaller where as 13% said it would be closed if they failed to get the loans they acquired from the financial institutions. In a nutshell, this implies that MSEs gave a significant portion of attribution for their growth to MFI loans

Figure 4: The impact of financial leverage

Hadn't you got any loan, how that impacted your business



Source: Survey result, 2020

Respondents were also enquired as to how they utilize the loan. Business expansion or working capital (25%), acquisition of fixed assets (20%) and product quality improvement (17%) are the major loan purposes and usage of MSE loans. This implies that MSEs have high need for bridge financing (i.e. short term loans less than one year to finance daily operations).

4.4. Correlation analysis

Correlation analysis is a statistical method used to evaluate the strength of relationship between two variables. Perfect positive correlation is shown with the value of +1 where as weaker positive and negative correlation is indicated by the coefficients between +1 and -1. (Saunders, 2009).

The Pearson's correlation results confirmed a strong positive correlation of two variables (firms' financial leverage and firm age) with job creation, both at 1 percent level of significance. Firm size has a positive relationships with job creation again at 1 percent level of significance. The fact that MSEs with higher financial leverage ratio produce more jobs. This confirms that leverage is among the most important influencer variables on job creation performance of firms.

In addition, there is a positive and significant relationship among financial leverage, size and age that implies that a firm's financial leverage increases with its size and age.

Table 9: Pearson Correlations

Pairwise correlations					
Variables	(1)	(2)	(3)	(4)	(5)
(1) logemp_current	1.000				
(2) Size	0.547 (0.000)	1.000			
(3) Lev	0.826 (0.000)	0.421 (0.000)	1.000		
(4) firm_age	0.889 (0.000)	0.419 (0.000)	0.786 (0.000)	1.000	
(5) sector	-0.068 (0.330)	-0.194 (0.005)	-0.069 (0.322)	-0.065 (0.352)	1.000

Source: Survey result, 2020

The correlation coefficient between sector and job creation is negative, however, sector is not statistically significant.

4.5. Assumptions of Ordinary Least Squares

1. Multicollinearity

The existence of perfect multicollinearity need to be checked as part of the OLS assumption. This assumption requires inspecting the inexistence of perfect multicollinearity within independent variables. To ensure that multicollinearity is not driving the results, the variance inflation factor (VIF) is checked as an empirical test.

Table 10: Variance Inflation Factor

	VIF	1/VIF
Size	1.288	.776
Lev	2.691	.372
firm age	2.686	.372
Sector	1.04	.962
Mean VIF	1.926	.

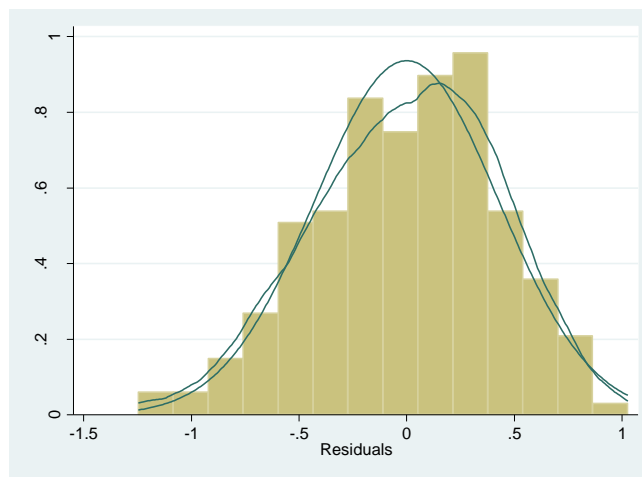
Source: Survey result, 2020

The VIFs are all less than 10, indicating that multi-collinearity is not a serious concern (Kennedy 2008; Neter 1996).

2. Normality

In order to examine the distribution of any value of the dependent variables in the model associated with the independent variables, normality test of histogram and Jarque-Bera normality test are used. The results of the test confirmed that the error term distribution is normal

Figure 5: Normality test, histogram



Jarque-Bera normality test: 3.529 Chi(2) .1713

Jarque-Bera test for H_0 : normality:

In addition, skewness and kurtosis tests were applied and no Skewness and Kurtosis problem observed.

Table 11: Skewness/Kurtosis tests for Normality

Skewness/Kurtosis tests for Normality

----- joint -----

Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	adj_chi2(2)	Prob>chi2
resid	206	0.076	0.574	3.500	0.174

3. Homoskedasticity

OLS assumes that the variance of the residuals should be constant in the explanatory variables in the case of multiple regressions. The Breusch-Pagan tests evidenced heteroskedasticity problem. (See appendix 2 for the details). This is solved using robust function addressing the issue of correlation between error terms. .

4.6. Results of the Regression Analysis

The regression model, as evidenced by R square, underscores 86% variations in job creation is explained through a change in all independent variable included in the model. The remaining variation in jobs creation is explained by other independent variables outside the model. The significance of the model is revealed by F-statistics. All coefficients except for economic sector are statistically significant at one percent. The three independent variables of leverage, firm size and firm age have significant impacts on job creation.

Table 12: Results of the Ordinary Least Squares (OLS) Regression Analysis

Linear regression, robust							
logemp_current	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
Size	1.18e-06	0	5.42	0	0	0	***
Lev	1.261	.204	6.18	0	.859	1.663	***
firm_age	.075	.006	13.40	0	.064	.086	***
Sector	.028	.03	0.91	.364	-.032	.088	
Constant	.444	.099	4.50	0	.25	.639	***
Mean dependent var		1.611	SD dependent var		0.940		
R-squared		0.859	Number of obs		206.000		
F-test		276.812	Prob> F		0.000		
Akaike crit. (AIC)		165.218	Bayesian crit. (BIC)		181.857		

*** $p < .01$, ** $p < .05$, * $p < .1$

Hypothesis testing

Hypothesis 1. Firm size significantly affect job creation.

Firm size has beta value $1.18e-06$, ($p < 0.01$) which shows that the acceptance of the hypothesis. The result indicates for every one birr increase of firms capital as a measure of firm size, number of employee increases by 0.00012% , holding the other independent variables constant. On average, when firm size increases by 10,000 birr capital. there will be a 1.2% increase in job creation,

Hypothesis 2. Leverage significantly affect job creation.

Again, this hypothesis is accepted as leverage with a beta coefficient of 1.17 has a low P-value ($p < 0.01$). The coefficient indicates that for every additional unit of leverage ratio (total debt/total equity), number of employees increase by 126% , ceteris paribus. In other words, a 0.1 unit increase in leverage ratio will result number of employees to increase by 12.6% which highlights the significant effect of financial leverage on job creation.

Hypothesis 3. Firm age significantly affect job creation.

Firm age has a beta coefficient of 0.07 ($P < 0.01$) and hence the hypothesis is accepted. When firm age increases by 1 year, current employees will increase by 7% , holding all other variables constant. Firm age significantly affects job creation.

Hypothesis 4. A firm's economic sector types significantly affect job creation

Economic sector types has a beta coefficient of 0.034 . However, its p-value is 0.26 which is greater than 0.05 . This demonstrates that economic sector types does not affect job creation significantly. As a result, the hypothesis is rejected. Overall, the regression model is:
$$\text{Jobs creation} = 1.18e-06\text{Size} + 1.26\text{Lev} + 0.075\text{firm_age} + 0.028\text{Sector} + 0.444$$

Discussion of the results of the study

The result of the correlation analysis showed there is a positive association between the three independent variables (firm size, leverage and firm age) with job creation. Financial leverage is strongly and positively related to job creation. Firms with greater financial access and debt capacity, thus higher leverage ratios, have created more jobs. The result is in an agreement with previous studies (Carpenter and Petersen, 2002; Heisz and LaRochelle-Côté, 2004; Lang et al.,1996; Yazdanfar, 2011).

The first objective of the study was to examine the effect of firm size on job creation. The result of hypothesis one revealed that firm size (measured by current capital) has significant effect on job creation. This can be explained by any increment in amount of capital will enhance the job creation. The finding from this study is consistent with many researches.

Ayyagari, et al., (2016); EFSE (2007)and World Bank, (2015) noted that firm size matters for job creation. EFSE (2007) confirmed that small businesses hire more people than micro businesses where as bothAyyagari, et al., (2016) and World Bank (2015) explained that medium businesses have created more jobs than the small ones. Heisz and LaRochelle-Côté (2004) stated that smaller firmstend to shed more labour than healthier firms for an equal sized drop in product demand. You and Fan(2019) in their empirical study of net job creation, firm size and firm age in china revealed that young enterprises (under the age of 5) are the major force in creating jobs.

Yazandanfar (2015) confirmed that that the firm characteristics of sizeinfluence the demand for labour by SMEs, and thus the creation of more jobs

The second objective of this study was to examine the effect of financial leverage on job creation. The study confirmed that leverage significantly affect job creation. This finding is consistent with other studies (Carpenter and Petersen, 2002; Heisz and LaRochelle-Côté,2004; Lang et al., 1996). They confirmed that firms with higher financial leverage ratios create more jobs than do firms with lower financial ratios.Ayyagari et al. (2016) in the access to finance and job growth study stated that MSME firms with access to loan have on average between a 1 and 4 percentage point larger employment growth than those without a loan Likewise the study

findings of Heisz and LaRochelle-Côté, 2004a argued leverage have a positive effect on job creation.

The third objective of the study was to investigate the effect of firm age on job creation. As it is showed in hypothesis three result firm age significantly affect job creation. This result is consistent with Audretsch (1995), in the study it was found that there is a strong relationship between age and job creation. In addition Broersma and Gautier (1997) stated that firm age has more contribution to job creation. Oliveira and Fortunato, (2006) agreed that the existence of relationship between firm age and job creation.

The fourth objective of the study was to look into the impact of firm's economic sector on job creation. Unlike other previous studies (EFSE, 2007;Antonucciand Pianta, 2002; Evangelista and Savona, 2003, the study rejected hypothesis four that economic sector of firms significantly affect job creation.

CHAPTER FIVE

SUMMARY OF MAJOR FINDINGS, CONCLUSION AND RECOMMENDATION

5.1. Summary of findings

The study found out the following findings after examining the data

5.1.1. Descriptive analysis

The average firm age of MSEs is 7 years. Firm age increases with size of enterprises which reveals the graduation of MSEs to the next level.. Small businesses tend to hire more employees compared with micro enterprises. Job creation is highly correlated with firm size as the growth is better with small compared with micro businesses.

Loan access as evidenced by financial leverage improves the employment capacity of MSEs. Loan size increases with firm size. The bigger the better as far as employment is concerned. MSEs gave a significant portion of attribution for their growth and performance (including job creation) to MFI loans. Three quarters perceived their businesses would have been smaller without loans and half a quarter imagined it would had been closed.

MSEs have high need for bridge financing (i.e. short term loans less than one year to finance daily operations). These needs include payroll, rent payment and inventories. Shortage of working capital is the major constraint affecting the job creation performance of MSEs across their firm size. This is not surprising as access to credit is the major constraint for the growth of MSEs business expansion or working capital, fixed asset investment, purchase of raw material are the major purposes and usage of the loan for MSEs. This shows that MSEs are highly in need of external finance to address daily operations financial difficulties including payroll

5.1.2. Results of the OLS Regression Analysis

OLS is used to measure the effect of access to credit using mainly financial leverage as a measure on job creation performance of MSEs. Firm characteristics of size, age and economic sector were included as independent variables in the model. Model result show high R squared witnessing the model goodness of fitness; OLS test applied to validate and address issues.

The result of the model found that financial leverage, firm size and firm age have significant impacts on job creation of MSEs. However, no statistical significance is observed to show the influence of economic sector on job creation.

5.2. Conclusions

The study aimed at examining the effect of access to finance (measured by financial leverage) on job creation performance of MSEs, controlling for firm characteristics. The firm characteristics of MSEs impacting their job creation analyzed in this study included enterprise size, firm age and economic sector.

The ordinary least square regression analysis uncovered that the financial leverage of MSEs has a positive and significant impact on job creation. It also confirmed that job creation is significantly impacted by firm size and firm age. Each additional years of firm level experience (firm age) increases the job creation by 7 percent.

Firm size is a factor that has shown a positive and significant impact on job creation. Small businesses create more jobs than micro and as they are by far effective to grow and hire more people.

Most importantly, loan access measured by financial leverage has substantial impact on firms' job creation. For a 0.1 decimal increase in financial leverage ratio, number of employees will be increased by 12.6%.

Therefore, financial access represented by financial leverage is the pressing need abruptly escalating MSE firm's and resolving the rising unemployment problem and be able to contribute towards the journey for industrialization and economic transformation. Hence, all financial stakeholders mainly financial institutions should owe to tangibly impact on this burning problem of the MSE firms. Policy makers especially the NBE need to play an important role in this regard through coming up with market oriented policies and regulation that capture the firm level characteristics and financial needs of MSEs as they are key job creators

5.3. Recommendations

The MSE sector is strategic for the economic development and creation of jobs for the Government of Ethiopia. The job creation performance of MSEs is mainly affected by access to finance or their abilities to have more financial leverages. Firm characteristics (firm age and size) have also significant influence on job creation of MSEs.

Policy makers should strive to put in place regulatory framework for the financial sector that encourage financial institutions to avail more financial access to MSEs. Such regulation will allow financial institutions (including MFIs) to relax their requirements and come up with tailored products and services to meet the credit needs of MSEs. To this effect, understanding the role of firm characteristics (specifically firm size and firm age) on job creation is important. Increasing access to funding to MSEs is key for their contribution to job creation and eventually to the economy. Therefore, it is highly recommended that policy makers (such as NBE, Job Creation Commission and Ministry of Finance) should mobilize financial resources both domestically and from development partners to be channeled through financial institutions (mainly MFIs) to MSEs.

Financial institution specifically MFIs should strive to avail financial access to MSEs so as to enable them to flourish and create more jobs. To this end, financial institutions should proactively mobilize resources from diversified sources and dedicate a certain portion of their portfolios to MSEs. It is recommended that MFIs should revise their product offerings to have market differentiation and target marketing based on enterprise size and firm age to have more appropriate and tailored products and services that meet the credit needs of MSEs.

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APPENDIX

Appendix I: Survey Questionnaire

Dear Respondent:

The purpose of this survey is to study **the effect of access to finance on employment and or job creation**. The survey will address the major challenges faced by SME in accessing finance, utilization, and their capacity to engage in employment creation along the way. The targeted respondents of study are the SME entrepreneurs/practitioners. This questionnaire is therefore, exclusively meant for academic purposes and remains to be highly confidential.

Part I : General Socio-economic Characteristics of top level Manager		
1	Sex	a) Male b) female
2	Age in years	
3	Marital status	a) Single d) Separated b) Married e) Widowed c) Divorce
4	Years of professional experience	
5	Average years of schooling	
6	Level of education	a) Read and write b) Primary education c) Secondary education d) TVET and diploma e) first degree and above
7	Have you had additional professional training ?	a) Yes b) No
8	which area of specialization have you been well trained ?	a) Accountancy/financial recording b) Business Managerial c) Leadership d) IT and computer science e) Business skill development f) other if any _____
Part II :Characteristics of SME		
1	Form of organization of your enterprise	a) Sole proprietor or single owner b) Partnership (group ownership) c) Family Business d) Corporate form
2	Enterprise sector and or Business activity	a) Production/manufacturing b) Trade wholesale/retail c) Services d) Construction

		e) Urban Agriculture
3	Enterprise age and year of establishment	year of establishment : _____ Age in years: _____
4	Business location	a) traditional markets b) neighborhood (home) markets c) Industry zone market d) Big market center e) other if any _____
5	Estimated distance from the nearest MFI in KM	_____ kilometer
6	What proximity advantage does your firm has?	f) Availability of raw material g) Market linkage h) infrastructure and public service i) Urban center advantage j) Organizational and government support k) others, is any _____
7	Size of Enterprise (current)	Initial # of employees : _____ Current # of employees: _____
8	Average years of education and experience of all employees in your enterprise	Years of schooling: _____ Experience : _____
9	Amount of initial and current capital	Initial capital (ETB): _____ Current capital (ETB): _____ Total asset (ETB): _____
10	Have you introduced a new product or service in your business?	a) Yes b) No
11	Have you introduced new method of manufacturing or offering services ?	a) Yes b) No
12	Have you ever had trainings on new or improved technologies?	b) Yes b) No
13	Have you ever had any government support ?	c) Yes b) No
14	What kind of major changes have you recently made in your enterprise? (multiple answers possible)	a) Expanded and/or renovated buildings / real estate b) Bought new machines and equipment c) Added new product lines d) Hired more workers and/or qualified staff e) Improved quality of product (increased value added) f) Sold in new markets g) No changes just maintenance

15	Source of finance for the change?	a) Borrowing loan/credit from MFI b) Own profit increment c) Government support d) Capital increment e) Awards and or achievement fund f) Other if any, _____
16	Have you ever had government support ?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Part three: Loan Access and Financial Barriers		
1	Are you a client in any MFI	<input type="checkbox"/> Yes <input type="checkbox"/> No
2	Which MFI?	
3	Which other FI have you ever had loan?	a) Banks b) Credit association c) SACCOS d) Government organization e) Insurance companies f) Other if any _____
4	How many times have you got loan since establishment?	
5	The total volume of loan since establishment?	Total loan (ETB): _____
6	What are the fundamental barriers and constraints affecting loan access for your SME?	a) Collateral requirement b) high interest rate c) Limited amount of loan provision d) shorter loan duration e) lack of trust and confidence on our business f) weak business and lower return on investment g) if other, specify-----
7	Have you immediately got loan when needed?	a) Yes b) No
7	How do you rate the ease of access to loan in MFI?	a) Fair/reasonable access b) Adequate access c) Very limited access d) Moderately limited e) No access at all
8	Did you identify and investigate FIs before taking a loan?	a) Yes b) No
9	Mode of repayment?	a) Monthly b) Quarterly c) Biannual d) Annual

10	Why did you choose MFI other than the banking sector?	<ul style="list-style-type: none"> a) better interest rate b) better loan products and conditions c) Was closer to where you live d) Had friendlier and more cooperative staff e) Was recommended to you as an institution with a good reputation f) Had no noticeable differences to other institutions
11	What special advantages have you got from the MFI?	<ul style="list-style-type: none"> a) Low interest rate b) Flexibility of the loan c) Ease of access and limited control d) No collateral requirement e) Convenient loan repayment mode f) others, if any _____
12	What is/are the main reason/s if you would not borrow again from any MFI?	<ul style="list-style-type: none"> a) I do not need a loan to continue my business b) I have found lower-cost loan offers elsewhere c) I am not satisfied with the process and way I was treated by the FI staff d) (not applicable)
13	If you had not got a loan from any FI, how would it impact your business?	<ul style="list-style-type: none"> a) Nothing would have been changed b) My business would be a little smaller (< 50% smaller) c) My business would be a lot smaller (> 50% smaller) d) My business would be closed e) other, if any
Part four: Employment and Job creation		
1	The type of job widely available in your enterprise ?	<ul style="list-style-type: none"> a) Accountant or Auditor b) Skilled Person c) Technical Job d) Managerial and or leader e) laborers and messengers f) other, if any
2	What does the trends of employment records of your firm looks like?	<ul style="list-style-type: none"> a) Increasing b) Decreasing c) Constant or no change at all d) fluctuating (irregular)
3	What are the main problems affecting job creation and overall performance of your enterprise? (multiple response question)	<ul style="list-style-type: none"> a) lack of skilled and educated man power b) lack of managerial talent and leadership ability c) shortage of working capital and financial problem d) Inefficient use of finance and lack of

		investment opportunity e) weakness in innovation and business development f) Tough competition and inability to cope up g) lack of market and business opportunity
4	Could you name the main obstacles to increase employment in your enterprise? (Multiple answers possible)	a. Level of business does not require more staff b) Government regulation (taxes and laws) hampers hiring of staff c) Loan amounts I can borrow are too small to allow me to hire more staff d) Problems in finding qualified staff e) Enough labor force in my family f) high salary requirement and turn over

Part Five: Summary and all-inclusive Questions

1. Loan Portfolio

No	Loan Year	Loan term	Loan amount	Loan paid	Outstanding
1					
2					
3					
4					
5					

2. Firm capital and employment Summary

Year (start form the year of establishment)	Initial capital	Initial # of employees	Current # of employees	Current capital
1995				
2000				
2015				
2020				

3. Firm employment profile in your firm before and after taking loan

No	Items	Before loan	After the 1st loan	After the last two loans
1	No. of unpaid family members workers			
2	No. of paid family members workers			
3	No. of full-time employees			
4	No. of part-time employees estimated as % of one full-time position			
5	No. of seasonal employees estimated as % of one yearly full-time position			
6	How many employees/workers were/are registered?			

4. What was the main purpose of your loan or loans?

Fill according to the degree of importance as (0 not important), (1 less important) (2 moderately important) (3 very important).

No	Purposes	0	1	2	3
1	New product development				
2	For working capital & business expansion				
3	For purchase of Inventory (stock)				
4	For purchase of raw material				
5	Repair of workplace/asset				
6	Cash portfolio (Improving liquidity)				
7	Investment (fixed asset)				
8	Replacement of same asset				
9	Purchase of new assets (machinery, equipment and vehicle)				

5. Perception Based Ranking of Firms Problem and Constraints

No	Items	Sever (5)	Major (4)	Moderate (3)	Minor (2)	Not at all (1)
1	Financial Recording					
2	Limited access to loan					
3	High level of corruption					
4	Weak managerial talent					
5	Lack of innovate ability					
6	Poor infrastructural facility					
7	Lack of raw material					
8	Limited market linkage					
9	Lack of government support					
10	Weak investment portfolio					
11	non proactive leadership ability					

Thank you very much for your time and dedication !!

Appendix 2: Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance

Variables: fitted values of logemp_current

chi2(1) = 19.66

Prob> chi2 = 0.0000