ADDIS ABABA UNIVERSITY

SCHOOL OF GRADUATE STUDIES

FINANCE AS SUCCESS OR FAILURE FACTOR FOR MICRO AND SMALL ENTERPRISES IN ADDIS ABABA: THE CASE OF ARADA SUB-CITY

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STATEMENT OF DECLARATION

I, Brhane Tadesse, declare that this study entitled**" Finance as Success or Failure Factor for Micro and Small Enterprises in Addis Ababa: The Case of Arada Sub-City**" is my original work and has not previously been submitted to any University for a degree. Furthermore, all sources, in this thesis, referred to have been duly acknowledged.

Name	**Signature**	**Date**
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This thesis has been submitted for examination with my approval.

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Advisor

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APPROVED BY BOARD OF EXAMINERS

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Examiner	**Signature**	**Date**

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LIST OF ACRONYMS

MSEs	Micro and Small Enterprises
LDC	Least Developed Country
MSEEIS	Micro, Small, Enterprise Equity Investment Scheme
OECD	Organization for Economic Co-operation and Development
IPO	Initial Public Offering
MFI	Microfinance Institutions
VAT	Value Added Tax
TIN	Taxpayers Identity Number
MoFED	Ministry of Finance and Economic Development

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ABSTRACT

The role of micro and small enterprises (MSEs) in employment and income generation is increasingly recognized and has become a major playing field for policy makers with the purpose of enhancing growth and alleviating poverty. This study investigates about finance as success or failure factor for micro and small enterprises. The study has conducted based on a survey covering 49 randomly selected MSEs in Addis Ababa Arada Sub-City. Interviews and questionnaires have used as a tool to gather the information.

The main objective of this study is to examine whether firms have continued access to finance or not. Moreover, the study emphasized about loan size, interest rate, terms of loans and timely disbursement of the loans.

From the study, the most problems identified are lack access to finance and inappropriate delivery of the loans. Moreover, MSEs are facing difficulties to bring collateral, disbursement of loans on time, interest rate, loan size and other availability of financial instruments. These problems are hampering MSEs in their expansion, diversification, promotion and growth in some extent. The success of MSEs is measured in terms of their capital, number of employees, revenue, expansion and diversification of the work. From the analysis and discussions, it was possible to identify that finance was the major problem of MSEs. On top of this, the relationship between lack of access to finance and success of MSEs was negative. This was consistent with the theories; and it implies that finance is determinant to MSEs.

Most of MSEs stated that lack of access to finance constrains their growth, expansion, diversification, promotion and competitiveness. Indeed, financial sector policies often work against the ability of financial institutions to serve MSEs, though often unintentionally. Lack of competition in financial institutions limits MSEs to access finance. High risk and high transaction costs (real or perceived) associated with bank lending to MSEs likewise constrain access to finance.

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

It is obvious that finance plays a key role in any aspect of business operation. Finance[1] is used to start up, expand, diversify and for working capital of the businesses firms. Without finance, no one-business enterprise can achieve its objectives. As far as micro and small enterprises (MSEs) are concerned as part of business enterprises, they also need finance.

Mckernan and Chen (2005) stated that finance is the backbone of any business enterprise, including MSEs. MSEs need finance from start up to finance of its growth, expansion, diversification and smooth operation at any time in its life cycle.

Different authors defined MSEs differently in different place at different time. But, many authors concluded that MSEs in most parts of the world use number of employees to classify and define MSEs. However, in Ethiopia, it depends up on the capital investment of which 20,000-50,000 birr for small and less than 20,000 birr for micro enterprises (Hailay, 2003).

Micro and small enterprise is a pivotal resource for the development of Ethiopia not only for the contribution that it makes to poverty alleviation and job creation but also the

[1] In this case finance and capital have the same meaning

sector is a base for entrepreneurial endeavor and the potential for new business development. To play this role, finance takes a lion share.

However, the sector is facing financial challenges, which impeded its role in the economy. These challenges are lack of access to credit, insufficient loan size, time delay and collateral (Gebrehiwot and wolday, 2006). In addition to this, Wattanapruttipaisan (2003), Molhotra *et al*. (2006), Beck (2007) and Vandenberg (2009) also stated that acute financial constraint is a strong obstacle for MSEs in developing countries.

According to Molhotra *et al*. (2006), MSEs play a pivotal role in developmental goals such as in improving living standard, distributing income fairly among low level and high level group, reducing unemployment rate, fostering linkages among various economic sectors, easy to begin and expand, labor intensive, require small capital, low technology, and little know - how, this sector is receiving due attention of policy makers and development practitioners. Furthermore, MSEs serve as a bridge to reach at the technically advanced medium and large enterprises. It is undeniable to the fact that there is expansion and diversification of MSE sectors in our country, Ethiopia. However, these expansion and diversification of MSE sectors is not satisfactory. So, the country should work or dig out more and more on this sector to compete with other developed nations.

In connection to the idea of Molhotra *et al*. (2006), Wattanapruttipaisan (2003) pointed out the role of MSEs in providing individuals with better job opportunities, facilitate the import and export transactions among countries. Generally, to create comfortable ground for MSEs, finance is the major determinant one.

Among the seven classifications of MSEs, the study has focused on three MSE sectors, which are Construction materials, Textile and Metal and Woodwork in Addis Ababa, Arada Sub-city.

1.2. Statement of the Problem

In almost all economies of the world, micro and small enterprises are vital for sustained growth**.** MSEs are generally regarded as the driving force of economic growth, job creation and poverty reduction in developing countries. They have been the means through which accelerated economic growth and rapid industrialization to be achieved (Okpara and Wynn, 2007).

The difficulties that MSEs encounter when trying to access financing consists of many incomplete range of financial related activities, regulatory rigidities or gaps in the legal framework, lack of information on both the bank's and the MSE's side. Banks may avoid providing financing to certain types of MSEs in particular for those which are in start-up and very young firms that typically lack sufficient collateral, or firms whose activities offer the possibilities of high returns but at a substantial risk of loss (OECD, 2006).

Wattanapruttipaisan (2003) stated that acute financial constraint becomes a strong obstacle for MSEs in developing countries. Malhotra *et al* (2006) goes some way to confirm the above explanation that lack of access to finance is hampering the growth and competence of MSEs.

In contrast to this, Riba (1999) argued that the major constraint for MSE growth, expansion, diversification and promotion is not the shortage of access to finance. It is rather lack of access to medium and long-term credit (time duration of credit) that hinders MSEs. Because, most credits available for MSEs are on short-term loans. There are also some authors who shared the arguments of both sides. Malhotra *et al* (2006) is a good case in point. In their article, they stated that the major constraints of MSEs which are not only lack of access to finance but also lack of medium or long term credit, appropriate loan size, technology and know-how. Pissarides (2000) corroborates that credit constraints constitute one of the main obstacles to growth, expansion, diversification and promotion of MSEs.

In Ethiopian context, as to the Ethiopian government's strategy, Growth and Transformation plan, micro and small enterprises are the bridge to achieve the goals of the government (MoFED, 2011). Since Ethiopia is a developing country, policy makers of the country pay due attention for MSE sectors. Due to their low capital requirement, easy of start-up and operate, easy to operate in urban and semi urban areas or environments with small expenditure, they attract the attention of the government. Even though MSEs are believed to require low capital expenditure, still finance is the primary requirement to start and run MSEs. Capital is important to start-up, expansion, diversification and operation of MSEs. However, due to:

- Limited access to working capital and long-term credit
- Legal and regulatory restrictions
- Inadequate infrastructure
- High transaction costs
- Limited managerial and technical expertise
- and other multiple and interrelated constraints (OECD,2006),

MSEs growth, development, expansion, diversification and promotion is not progressing much as expected to achieve.

The empirical studies of Gebrehiwot and Wolday (2006), who conducted their research on this subject in Ethiopia, pointed out that inadequate loan size, loan durations that do not match with the gestation periods and cash flow patterns of borrowers' activities financed by the loan, failure to disburse loans timely, and the tendency of group collateral requirements are the problems of MSEs in expanding and diversifying their enterprise. In addition to this, Mulu (2007), who conducted a study based on a survey consisting 974 randomly selected businesses in six major towns of Ethiopia in this subject, raised these problems. Similarly, the author stated that the smaller and younger firms grow faster than their counterpart does. This is due to the fact that at the initial stage, most of MSEs have access to finance both from microfinance institutions and families, but after they started their business they face lack of continued access to finance .Growth rate also differs by sector in which the enterprise operates. Manufacturing shows higher growth rate (13%) followed by service (11%) in contrast to trade (6.2%). Mulu (2007) listed some factors that might affect business growth and among which, type of sector, human capital, formality of the firm, and access to finance are the major ones.

Studies conducted so far concluded that the problem of MSEs are access to working capital and long term credit, inadequate loan size, inadequate infrastructure, high transactional cost, limited managerial and technical experts and marketing problems World Bank, (2008), Hailay (2003) and Gebrehiwot and Wolday (2006). Even though many authors have concluded the above listed problems of MSEs, they are still don't agree on each point. For example, Wattanapruttipaisan (2003) stated that lack of access to finance is a strong obstacle for MSEs in developing countries. In contrast, Riba (1999) argued that the major constraint for MSEs' growth, expansion, diversification and promotion is not the lack of access to finance rather its loan term, to medium and long-term credit, whereas Malhotra *et al* (2006) shared the arguments of both sides. In addition to this, these authors did not identify some more serious problems.

This research would focus on the effect of finance that is whether it leads to success or failure in the operation of the firm. The major focus is on adequacy of loan size, interest rate, loan term (loan duration), and the availability of loan on time (delays in loan request processing). The variables have been analyzed to assess whether the access to finance by itself is appropriate or inappropriate.

1.3. Objectives of the Study

1.3.1. General Objective

The general objective of this study is to assess or examine whether firms have continued access to finance or not.

1.3.2. Specific Objectives

Furthermore, the specific objectives of this study are:

- To identify the sources of finance for micro and small enterprise operators after establishment for expansion, working capital, growth and diversification.
- To examine the challenges that micro and small enterprises face in obtaining capital to finance their enterprise.
- To know the loan size, interest rate, credit period and time delays faced MSEs from credit providers. Appropriately, that is, whether adequate loan size, loan term, interest rate and timely disbursement of loans to assure their growth and expansion.
- To assess to what extent appropriate or inappropriate of finance has affected the growth, expansion and promotion of MSEs.

To attain these objectives, the researcher has distributed questionnaires to MSE owner managers. In addition to this, interview has also conducted for the 10 woredas and head office of Arada Sub-City governmental coordinator of MSEs.

1.4. Research Questions

Based on the problems identified from personal experience and literature review, the researcher developed the following questions.

1. What are the sources of capital to MSEs for expansion, diversification, growth and working capital?
2. What are the financial challenges of MSEs faced from their financial provider after establishment?
3. Is the interest rate appropriate?
4. Is term of credit suitable to the business cycle of MSEs?
5. Does the loan size meet the financial need of MSEs?
6. Do MSEs receive the loan at the right time without delay from credit providers?
7. What happen to MSEs that do not have continued access to finance?

1.5. Hypothesis

H1, Lack of access to finance is negatively correlated with success[2] of MSEs

1.6. Scope of the Study

The study deals with finance as success or failure factor for micro and small enterprise operators in Addis Ababa focusing on Arada Sub City. Micro and small enterprise comprises variety of business sectors. However, the scope and coverage of the study is on Construction materials, Metal and Woodwork; and Textile business sectors. Furthermore,

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[2] In this case, success is measured by capital, revenue, net income, number of employees, expansion and diversification of the work.

operators of micro and small enterprise in the Sub- City are facing financial challenges thereby this limits somewhat, in expansion, diversification and growth of MSEs, which are not as expected too. To examine the access of finance and loan delivery conditions in relation to interest rate, loan size, credit term and delay in disbursing the loan, the researcher is limited in Arada Sub-City.

1.7. Significance of the Study

This study is significant to present the current picture of MSEs in relation to their finance. The findings of the research are expected to contribute a lot for different stakeholders. The following are some among the significance of the study.

1. To recommend policy makers in order to implement and revise the credit policies of MSEs.
2. To direct ways to the operators of micro and small enterprises on how to finance their enterprise successfully.
3. It would help other researchers as a point of reference to conduct further research on this subject.

1.8. Limitations of the Study

The result of this study is believed to be very important. However, in conducting this study, there were some limitations. These are shortage of time and finance. In addition to this, some respondents were not willing to respond. Furthermore, the enterprises are very dispersed which makes the study difficult to distribute and collect the questionnaires on the planed periods.

1.9. Organization of the Paper

The paper is divided into five sections. Chapter one deals with the background information. It contains statement of the problem, objectives of the study, research questions, hypothesis, scope of the study, significance of the study, limitations and organization of the paper. Chapter two deals with the key concepts that are used in the paper to place the problem in a broader perspective of literature. Chapter three presents methodology while chapter four presents discussions and analysis of the empirical data. The last, but not the least, chapter draws conclusions of the findings and some recommendations as a way forwarded.

CHAPTER TWO

REVIEW LITERATURE

2.1. Definition of Micro and Small Enterprise (MSEs)

There is no universally accepted single definition of micro and small enterprises. Hailay (2003) defined small enterprises in Ethiopia, having a capital investment from 20,000 birr to 50,000 birr, while micro enterprises are having less than 20,000 capital investment. This definition is in case of Ethiopia but there are many other countries that use number of employees to define micro and small enterprises.

Malhotra *et a*l (2006) defines MSEs as business institutions, which run their business activities under the supervision of their owners. The authors also specifically defined MSEs as entities that focus on micro-enterprise and are typically informal having less than 10 employees.

Hailay (2003) and World Bank group (2004) stated that there are two methods to define MSEs; namely size criteria and economic control. In relation to size criteria, Hailay (2003) and World Bank group (2004) pointed out that different countries used various criteria such as number of employees, sales volume, asset size, insurance and volume of deposit to define MSEs.

However, many countries commonly used the number of employees as the dominant criteria to define MSEs. Japan, Canada, and USA are good examples in point. Levitsky

(1988) strengthened the suggestions of Hailay and World Bank. For better classification, the World Bank group (2004) tabulated their definition as follows.

Table 2.1: World Bank Group Definitions of Types of Enterprise

Type of enterprise	**Number of employees**	**Extent of total asset**	**Annual turnover**
Micro enterprise	1-10	Less than $ 100,000	Less than $100,000
Small enterprise	11-50	Between $100,000 and $3 million	Between $100,000 and $3 million

Sources; World Bank Report, 2004

With regard to economic control, Hailay (2003) stated that a given business can be considered as micro and small enterprise, if market share, independence and personalized managements are taken in to account. Other authors like Levitsky (1988) also support this suggestion.

Actually, it is difficult to say there is single definition of MSEs since it depends not only on the level and number of employees but also on technologies and technical complexities of production, degrees of skills demanded from employees and managers, end use of products, economic level of the country in which they operate, law of the land and so on, which varies from country to country (Beck and Demiruc-Kunt, 2007). In this study the definition of Hailay (2003) has been applied.

2.2. Importance of Micro and Small Enterprises

MSEs are vital for economic growth and development in both industrialized and developing countries by playing key roles.

Ogujiuba, Ohuche and Adenuga, (2004) stated that MSEs can be seen as instruments of employment and income generation, human development and poverty alleviation, export promotion, import substitution, stimulation of private ownership, competition and entrepreneurship; as a result, policymakers, academics, and the international donor agencies have been focused on the role of MSEs.

Paul and Frederic (2000) stated that industrialization is a carrier of economic growth. Nonetheless, for a developing country such as Ethiopia, whose economy is still predominantly agrarian, the emphasis on industrialization should not be stressed by undermining the role of other sectors in the economy, rather a complementary balance has to be established between these sectors to reap the relative benefits accruing to each other, resulting in acceleration of the economic growth.

Like Ogujiuba, Ohuche and Adenuga (2004), Okpara and Wynn (2007) stated that in almost all economies, micro and small enterprises are vital for sustained growth**.** MSEs are generally regarded as the driving force of economic growth, job creation, and poverty reduction in developing countries. Besides, MSEs are the means through which accelerated economic growth and rapid industrialization have been achieved.

Similarly, Fan (2003) emphasizes the importance of MSEs as the engine of growth, essential for a competitive and efficient market and provides of new employment by creating new jobs in many countries. The author further argued that they are major source of technological and new products innovation. Thus makes critical for poverty reduction in most developing countries.

In addition to the suggestion of Fan (2003), Hailay (2003) added some points by saying that large number of MSEs create competitive market pressure. On top of this, the author stated MSEs play an essential role in subcontractors in the downsizing, privatization and restructuring of large companies, tends to employ poor and low-income workers, and sometimes serves as the only source of employment in poor regions and rural areas. Furthermore, MSEs play important role in developing countries where poverty is epidemic

Fan (2003) has stressed the importance of MSEs in developing countries like Ethiopia. In addition to this, the author raised the advantage of finance. Starting a business or expanding an existing one in today's environment, brings not only opportunities but also challenges. New technologies and better access to global markets provide increased business opportunities.

At the same time, increased competition, insistence on quality and unremitting pressure for lower costs, just to mention a few issues, represent major challenges for businesses worldwide. Micro and small enterprises often lack scale, financial resources and the capacity to handle complex business management issues. MSEs are a vital source of new jobs, exports and economic contribution in all countries. Ensuring the growth of this sector remains a challenge for policy makers (Geiger, 2005).

Different MSEs have distinct values for different countries development due to the technological revolution and variation in degree of flexibility among the MSEs as part of economic sectors.

Mckernan and Chen (2005) noted that MSEs are highly importance for various reasons. Accordingly, MSEs play a pivotal role in economic developments, minimizing poverty and ensuring self-sufficiency. To achieve this, what is interesting here is that the authors had never failed to recognize the role of finance to materialize the intended objectives of MSEs. Malhotra *et al* (2006) advocated that MSEs play crucial roles in enhancing the majority of the population and in alleviating poverty.

Beside to this, Mckernan and Chen (2005), Wattanapruttipaisan (2003), Michalowski (2008) and their co-authors highly underline the role of finance for the development, expansion and diversification of MSEs. The authors further explained that MSEs are quite different from traditional welfare programs, which are, characterize by their minimal consumptions level as a goal. In contrast fashion, MSEs Programs are potentially efficient ways of helping people to be self-sufficient, if things especially capital handle appropriately and effectively.

Micholowski (2008) works goes some way to reveal the importance of MSEs in augmenting government revenue that could be used for the expansion of various social institutions. Strong financial systems can promote new-firm entry, enterprise growth, innovation, equilibrium size, and risk reduction, and then they will almost inevitably improve aggregate economic performance.

2.3. Importance of Financing Micro and Small Enterprises

Finance is the heart of improvement process for MSEs (World Bank, 2008). Finance is necessary to help MSEs to set up and expand their operations, build up new products, and invest in new staff or production facilities. Many MSEs start out as an idea by one or two people, who invest their own money and perhaps turn to family and friends for financial help in return for a share in the business. As per World Bank report (2008), it is indicated that improving access and building inclusive financial system is relevant to economy at all level of development. The challenge of better access means making financial service available to MSEs. However, if they are successful, there come a time for all developing MSEs when they need new investment to expand, innovate and diversify further. Nevertheless, MSEs often run into problems, because they find it much harder than larger businesses to obtain financing from banks, capital markets or other suppliers of credit.

It is stated that "financing gap"[3] is all the more important in a fast-changing knowledge-based economy because of the speed of innovation, expansion and diversification. Innovative MSEs with high growth potential, many of them in high-technology sectors, have played a pivotal role in raising productivity and maintaining competitiveness in

[3] Financing gap refers to the difference between that MSE owners want (ambition) to borrow and the actual supply of money given to MSEs by creditors.

recent years. Nevertheless, innovative products and services, however, great their potential needs investment to flourish. If MSEs cannot find the finance they need, brilliant ideas may fall by the wayside and this represents a loss in potential growth for the economy. The "bag less"[4] vacuum cleaner and the "wind-up" radio or flashlight which need no batteries are now common household items, but nearly failed to see the light of day because their inventors could not find financial backing to transform their ideas into production (OECD,2006).

2.4. Source of Finance for Micro and Small Enterprises

There are no single independent sources of finance that can be useful to run MSEs. Rather several MSE attempted to secure their finance from different sources. Before a business sells its first product or delivers a service to the market, it needs financial resources for product development, sales, marketing and promotional efforts, administrative support, the company's formation, and countless other critical business functions. Capital is not only perceived as just the amount of cash on hand but also as the amount of financial resources available to support the execution of a business plan. While financial resources come in different forms, types, and structures.

There are two main basic types of financial resources available to most businesses: debt and equity (Nichter and Goldmark, 2005). MSEs financed their investments and

[4] Bag less is a proverb given by the OECD and implies that nothing is done without finance. Finance is crucial for business firms.

operations in many different ways, reflecting a wide range of both internal and external sources.

The availability of external financing depends not only on each MSE's individual situation but also on the wider policy and institutional environment supporting the enforceability and liquidity of the contracts that are involved in financing MSEs. Availability also depends on the existence and effectiveness of a variety of intermediaries and ancillary financial firms that help to connect fund providers and users. Bank finance is typically the major source of external finance for all firms, regardless of size (Beck, -Kunt, and Maksimovic, 2008). In today's business world where consumer's credit and other types of credits being offered by banking sectors in developed and developing countries, it is amusing to see the MSEs, change agent, suffer from lack of access to finance in these developing countries. This problem is also common to our country Ethiopia.

Hailay (2003) spelt out that there are three possible sources of finance, namely, owner managers own investment, business expansion scheme and venture capital. Levitsky (1988) also discussed the possible sources of finance for MSEs which consistently support the idea of Hailay, (2003). MSEs tend to progress through a distinctive life cycle. These firms normally begin by raising funds from family, friends, and close associates, sometimes supplemented by grants from government, foundations, Universities, industry or special facilities such as seed capital funds. These are typical sources of equity finance for fast growth enterprises as they progress through their life cycle. Following initial funding from family and friends, and possibly grants, the enterprise may obtain funding successively from informal equity investment, such as “business angels” before moving on to formal venture capital. The entire process will reach its culmination when the firm “exits” as a mature company through initial public offering IPO or a trade sale (Geiger, 2005).

As far as personal manager own investment is concerned, Levitsky (1988) and Hailay (2003) conceded that some MSEs are capable of generating their finance from privately own capital. With regard to business expansion scheme (loan), the authors explained that MSEs could also obtain finance from governmental and nongovernmental organizations along with their private sources of capital. This suggestion is further confirmed (Vandenberg, 2009) who demonstrated the significance contribution of government and its policy in providing MSEs with necessary financial support. According to Vandenberg (2009), government should devote a lot to facilitate MSEs through strengthening lending institutions and issuing favorable monetary policy. In case of the sources of finance from venture capital, Hailay (2003) illustrated how several MSEs able to achieve a financial support from pension funds, insurance companies, investment trust, regional development agency and private individuals.

Wattanapruttipaisan (2003) has addressed the issue in a similar fashion but with a considerable difference in an emphasis. Having stating how MSEs are able to gain the financial support from the aforementioned sources, Wattanapruhipaisan (2003) make it more explicit how borrowers were provided with a financial support after gathering information about them. This idea was strongly explained by Levitsky (1988) in his study.

Many countries extend financing directly to target MSEs in the form of debt or equity investment, guarantees or subsidies. Direct financial support mostly takes in the form of grants, loans and loan guarantees. A crucial precept guiding policy is that program should be designed with careful attention to incentives.

Michalowski (2008) stated the sources of finance for MSEs in a simplest way. As to the author, the sources of finance can be categorized as informal and formal ones. The author argued that informal sources of finance consists of own sources, family and friends or saving and credit associations which are mostly used by MSEs. This point is also strongly supported by Levitsky (1988). In relation to formal sources of finance, Michalowski (2008) and Levitsky (1988) clearly concerned that formal sources of finance are not easily accessible to MSEs, which are expected to accomplish several requirements from formal sources of finance. This idea was opposed by Beck, Kunt, and Maksimovic (2007).

2.5. Financial Requirements of Micro and Small Enterprises

MSEs need money to finance a host of different requirements looking at the types and adequacy of fund available. It is important to match the use of funds with appropriate funding methods. Gebrehiwot and Wolday (2006) informal finance is well suited to certain kinds of MSE, especially those owned by individuals or families with modest possibilities for expansion and/or with strong cash flows. To the degree that such firms eventually seek access to external financing, they usually are suitable for financing from banks, based upon their own cash flow or collateral. Dynamic high growths companies (MSEs) typically are high risk/high return ventures with untested outputs that require external financial support for a prolonged period and they must convince outside investors of the prospects for the firm.

Gebrehiwot and Wolday (2006) also stated that by their very nature, high growth companies must rely on external sources of finance. Indeed, unless the financial system is capable of meeting the specific needs of MSEs in obtaining external sources of finance, the system will have a serious gap. Such firms are difficult to value and involve higher than average risk. While the investor must assume any risk inherent in the project in which he invests, investment in high growth MSEs require a general confidence in the framework in which risk is assumed.

In similar concept, Ozar (2006) revealed that the banking system is unable to provide funds to support the MSEs because; they fail to fulfill the requirements. Banks often perceive lending to MSEs as a high cost and high-risk activity. Public policies should aim at encouraging the financial sector to launch multiple and diverse sources of finance for the MSEs. Locally owned banking institutions, such as credit cooperatives, tasked with serving local MSE interests, may be a better option for the provision of funding to MSEs than private banks, as is shown by the experiences of developed as well as developing countries.

External sources of finance depend upon reliable legal and institutional structures to protect the rights of outside investors as well as high levels of transparency to persuade the investor of the prospects for the investment project (Geiger, 2005).

Geiger (2005) pointed out that though MSEs account for a large share of enterprises, and represent potential employment and economic growth in emerging economies, they received a very low share of credit. Indeed, most of them are denied any access to formal financial markets. The characteristics of the banking system in emerging markets frequently inhibit MSE lending. Many banks are state-owned and their credit may be allocated based on government guarantees or in line with government targeting to develop specific sectors.

2.6. Financing Gap of Micro and Small Enterprises

To know the financing gap, it is important to assess the demand and supply sides. However, the researcher is focusing on demand sides (MSEs). The supply side needs other research.

Many countries that do not report an overall financing gap for MSE say that they do have a financing problem when it comes to innovative, precisely because they do not fit the mould applied in traditional financing. Since innovative MSEs tend to be newcomers to the market, or seeking financing for a new type of product or service, and usually have negative cash flows and untried business models, they represent a higher risk to banks and cannot be assessed in the same manner as traditional MSEs or large firms. One fundamental problem in dealing with the MSE's financing gap is lack of basic information about just how big such a gap may be (OECD, 2006). However, this idea was opposed by many authors who wrote their paper related to this topic in developing countries. For example, to the idea of Wattanapruttipaisan (2003) and Malhotra et al (2006)

On the other hand, Berger and Udell (2002) pointed out that because of the time and effort evolved in understanding the borrowers business and financial needs, relationship leading is costly for the lender and therefore requires either high spreads or large volumes to be viable. If the customer's credit worthiness is hard to evaluate, then there may be no alternative to make relationship lending. Here, it is important to note that relationship lending is at the core of the banking business continuing to give banks a comparative advantage over markets and nonbank financial institutions, even in developed country.

2.7. Terms of Loans for Micro and Small Enterprises

Hailay (2003) classified terms of loans as follows:

- Short-term
- Medium term and
- Long-term.

As to Hailay (2003) short-term credit are sought to be useful to overcome matured payments, overhead costs and seasonal financial problems. Whereas medium and long term credits is used to purchase tangible assets such as machinery, furniture, vehicles and buildings. As per to Hailay (2003) most of MSE credits have short time credit periods, which creates difficulty for MSE operators to paying back the amount borrowed. This problem comes due to inappropriate delivery conditions of loans.

Waterfield (2001) disclosed that proper design of financial products and their respective delivery methodologies is fundamental to an institution's effective and sustainable delivery of financial services. A financial product is defined by the various conditions attached to it, including loan size, term, interest rate, collateral requirements, usage restrictions and repayment terms. Delivery methodologies are the set of systems and procedures an institution develops in order to deliver its services to participants including MSEs. Waterfield (2001) was never forgotten to explain as the time duration of repayment for MSEs is not enough until they generate cash inflows.

2.8. The Role of the Government in Providing Finance for Micro and Small Enterprises

Some authors stated that the government should provide a suitable overall framework for financing. MSEs, in making the expansion of the capacity of the formal financial system, provide financing to MSEs an explicit aim of the overall financial reform that is under way at this time. Particular, the banking system must be further encouraged to change its pattern from lending to government and established enterprises to support the middle market.

The government has an extensive role in supporting regulating and sometimes directly intervening in the provision of financial services. But, one has to bear in mind that not all government action is quality effective rather some policies can be counterproductive. Complex systems responses can make intentioned policies misfire, so successful policy design must be context specific. Governance issues are important because policy success can depend on institutional quality. Measure are effective in environments that already enjoy strong institutions may fail elsewhere, at the sometime, a well functioning financial system itself is likely to contribute to strengthening national governance (World Bank, 2008).

According to the Ethiopian Ministry of Trade and Industry (1997), encouraging MSE owners is important to operate more transparently in order to have enlarged recourse to the formal market. In doing so, positive inducements mainly, the prospect of obtaining concrete benefits by using the formal markets should be emphasized. Be careful about policies that provide access to low cost funding but lead to lower rates of return for investors. Projects should be selected by their ability to generate earnings in a competitive market. This may be challenging for MSEs if the government is failing to fever MSEs operators.

According to Geiger (2005), good governance for MSEs should complement a strong finance. These are implementing policies to ease financing for early start-up, increase awareness among MSE operators range of financing options available through official programmers, private investors and banks , coordinate the activities of those supplying funds with the activities of those supplying consulting and other support programs, create special public funds through which public sector entities can make equity investments in MSEs in partnership with private investors, facilitate the development of business angel networks, mainly by providing infrastructure support, develop necessary investment vehicles and assess whether existing legal forms for MSEs investment need improvements.

In the same way, OECD (2006) stated that facilitate access capital to institutions increase institutional savings as part of the overall financial reform. OECD (2006) also explained assess whether existing regulations on institutional investors discourage investment in venture capital and adapt regulations on institutional investors to permit investment in venture capital, if investment is compatible with prudent investment management, it is the crucial way.

2.9. Financial Challenges of Micro and Small Enterprises for their Expansion, Growth and Diversification

There are many challenges that affect the success and effectiveness of MSEs. This subtitle is the most widely discussed point of emphasis among several authors. The argument of these authors is clearly indicated in the following paragraphs.

It is often assumed that lack of financing is a major constraint for MSEs, thereby limiting the growth, expansion and diversification of micro and smaller enterprises. The responses to the project survey are not definitive in confirming this assumption. Even if true, there is a need to confirm that lack of financing means exactly that. It could mean that enterprise owners lack the necessary skills to manage with the capital they have or to manage enterprise cash flow. The "lack of financing" answer may also reflect the principals' inadequate market knowledge when setting up their enterprises. That is, sales may grow more slowly than assumed and the initial funding may therefore not be sufficient to finance the operations in the meantime (Paetkau, 1999).

The study of Beck, Demiruc-Kunt (2007) indicated that barriers as availability of minimum account and loan balances account fees, fees associated with payments documentation requirements and processing ties are found to vary significantly both across banks and across countries.

In addition to this, the author also stated that indicators of access barriers are also found to be negatively correlated with the actual use of financial services, confirming that these barriers can exclude individuals from using Bank services.

In the best of times, MSEs frequently have difficulty getting loans approved. Enterprise owners believe that banks are too focused on collateral. Bankers agree that the absence of usual collateral is an issue but add others: the inherent higher risk of business failure among MSEs, a lack of complete and accurate financial information, lack of marketing know-how, and the absence of business plans. The current financial crisis has made it even more difficult for MSEs to arrange loans because banks now have an exceptionally high percentage of non-performing loans that weigh heavily on lending officers. In this situation, lenders become very risk averse and extremely cautious in assessing new lending proposals, even if the conditions present would have justified approval prior to the financial crisis (Green *et al., 2006*).

The other basic barrier is lack of documentation in most developing countries like Ethiopia. To have a bank account, an individual is required to have at least three documents, identity card/passport, wage slip, recommendation letter proof of domicile. Given high degree of informalities in these developing countries, only small portion of the population can produce most of this document (Beck, Remirguc-Kunt, 2007).

Geiger (2005) stated that SME sectors in its present form are largely an informal sector with many family owned and controlled firms and with heavy reliance on informal channels of finance. This sector receives relatively small amounts from the established financial system, i.e. Commercial Banks and the established capital market, which tends to channel resources to larger enterprises and the public sector. Meanwhile, many SMEs face limited access to external financing. According to OECD (2006) the difficulties that MSEs encounter when trying to access financing can be due to an incomplete range of financial products and services, regulatory rigidities or gaps in the legal framework, lack of information on both the bank's and the MSE's side. Banks may avoid providing financing to certain types of MSEs, in particular, start-ups and very young firms that typically lack sufficient collateral, or firms whose activities offer the possibilities of high returns but at a substantial risk of loss.

OECD (2006), MSEs tend by their very nature to show a far more volatile pattern of growth and earnings, with greater fluctuations than larger companies do. Their survival rate is lower than for larger companies – one analyst found that manufacturing firms with fewer than 20 employees were five times more likely to fail in a given year than larger firms. Thus, SMEs are at a particularly severe disadvantage when trying to obtain financing relative to larger and more established firms. It can also be difficult for potential creditors or investors to distinguish the financial situation of the company from that of its owners. The entrepreneur may have re-mortgaged his or her house to acquire the start-up funds for the company. For example, if there are two cars in the driveway, can one or both be considered part of the company's assets? If the owner dies, is there someone to take over the business or will it dies with him or her?

The MSEs may have several stakeholders but again unlike a large company, they are likely to be the friends and family of the MSE owner. What happens if one of them decides to take his or her money elsewhere – will the other stakeholders make good on the investment, will they look for a new investor in their own circle, or will they ask the Bank for more money?

This is a very different set of financial circumstances than that faced by Banks when dealing with large well-established firms, so the whole risk assessment is different. Banks and other traditional sources of credit may decide that MSEs represent a greater risk than larger companies, and respond by charging higher interest rates. This makes it more difficult for MSEs to borrow than for bigger companies, and may make it effectively impossible for many MSEs to borrow money at all because the price of credit is too high (Green et al., 2006).

If entrepreneurs cannot gain access to finance through the regular system, they may not start up a business or simply go out of business, a potential loss to the economy. But the other danger is that they will abandon the formal system altogether and operate in the informal economy, sidestepping taxes and regulations, and thus not making a full contribution to economic growth and job creation.

Wattanapruttipaisan (2003) mainly focused his discussion on financial problems that highly determine the activities of MSEs. The author pointed out several reasons discussing how the success of MSEs is highly influenced by financial problems. Accordingly, acute financial constraint becomes a strongly obstacle for MSEs in developing countries. The author also raised an idea about the introduction of technological innovation infrastructural developments and social institutions are predetermined by finance.

Malhotra *et al* (2006) goes some way to confirm the above explanation by stating that lack of access to finance highly influenced the growth, expansion, diversification and competence of MSEs. Malhotra *et al* (2006) were also revealing that many MSEs' failure to access finance is mainly associated with lack of collateral, inappropriate instrument of managing risk and Banks' financial policy distortion. The authors further explained that the influence of finance on MSEs is more pervasive than on large firms.

Honohan and Beck (2007) however, relationship lending is based on the loan officer's personal asses MSEs of the borrower and their long-term and repeated contractual arrangements will remain important in environments with weak infrastructure and informal economic activity. Relationship lending is costly for the lender and requires either high spreads or large volumes to be viable. If the customer's creditworthiness is hard to evaluate, then there may be no alternative to relationship lending. Indeed, limited access to credit in some difficult environments may be attributable to existing intermediaries' reluctance to participate in relationship lending on a small scale.

In line with the above many of the problems facing MSEs, Dubai United Arab Emirates International Conference (2010) identified lack of financing, difficulties in exploiting technology, constrained managerial capabilities, low productivity and regulatory burdens become more acute in a globalised environment. Getting a business enterprise off the ground or expanding it requires funding, and finding the right kind of finance is often a major difficulty for MSEs worldwide.

Furthermore, Paetkau (1999) also stated that the greater challenge to effective resolution of the non-performing loan problem might well be a cultural one. In some countries, business failure is routine, as is foreclosure action by lenders with a court judgment or under the terms of loan agreement. Shareholders and management accept the losses as part of the occupational hazard of being in business, and get on with their other activities. Companies are institutionalized that is, they are separate legal entities that have a life beyond that of their owners.

Similarly, the author also stated that it is hard to separate the personality of the owner from the actual business, regardless of the size of the latter. Foreclosure action or even accepting a price for assets lower than book value, is likely to be seen as a personal insult and therefore can be very hard to accept. Effective dispute resolution is not common and this is only partly a function of legislation and regulation. It remains to be seen how lenders and borrowers will manage the bad debt problem that is an essential prerequisite to the growth of new loans, including an expansion of lending to MSEs.

In addition to this, Seibel (1987) pointed out:

> *Most micro and small enterprises do not have access to institutional finance, technical assistance or special incentive schemes. This usually applies in both the formal and the informal financial sectors. Markets of various types were segmented with large enterprises in privileged and small ones in an underprivileged position. Most micro and small enterprises fall in to the informal sectors where they are ignore at best, or discriminated measures ranging from extortion to physical elimination. Concessionary financial programmers for MSEs have largely failed. Economically, they are not viable in terms of impact they reach but a minute proportion of their target group.*

Similarly, the author explained that existing financial programmers for MSEs face high transaction costs for both lender and borrower. Credit programmer for MSEs too often ignore savings as means of internal resources mobilization and saving habits as psychological basis for investment and repayment behavior. However, there is considerable differenced among several authors in relation to financial constraint as an obstacle for MSEs development. According to Wattanapruttipaisan (2003), an acute financial constraint is considered to be the major setback of MSEs' expansion, diversification and development.

In contrast to this, Riba (1999) argued that the major constraint for MSEs' development is not the shortage of access to finance. It is rather lack of access to medium and long-term credit (time duration of credit) that hinders MSEs' development to achieve the objective specified and to expand, as it needed.

There are also some authors who shared the argument of both sides. The article of Malhotra *et al* (2006) is a good case in point. This article stated that the major constraints of MSEs that are not only lack of access to finance but also lack of medium or long-term credit.

Riba (1999) is attempted to substantiate this argument using several reasons. According to the author, peoples with insufficient asset were not that much accessible to medium or long-term credit. Because, the author argued, people having low capital were considered as incapable of repaying their debt. As a result, financial institution or banks want not to borrow money for MSEs. This argument is echoed by (Michalowski, 2008) who underpinned that people with no land or physical infrastructure were no longer accessible to credit. Levitsky, (1988) also evidenced this argument.

In connection to this, Beck, and Maksimovic (2005), Klapper and Rajan (2006) stated that at any given level of financial development, small firms have more difficulty than large ones in accessing external finance. However, research shows that small firms benefit the most from financial development in terms of both entry and growth constraints relaxed.

In similar fashion, Klapper and Rajan (2006) access to finance and the associated institutional underpinnings favorably affect firm performance along a number of different channels. Functional improvements in the formal financial sector can reduce financial constraints more for small firms and others who have difficulty in either self-financing or finding private or informal sources of funding.

Research indicates that access to finance promotes more start-ups it operation. It is also essential to understand the problems facing micro and small enterprises development in African countries because they are significantly different from those facing developed countries. These obstacles include a lack of financial resources, lack of management experience, poor location, laws and regulations, general economic conditions, as well as critical factors such as poor infrastructure, corruption, low demand for products and services, and poverty (Okpara and Wynn, 2007).

2.10. Conceptual Framework

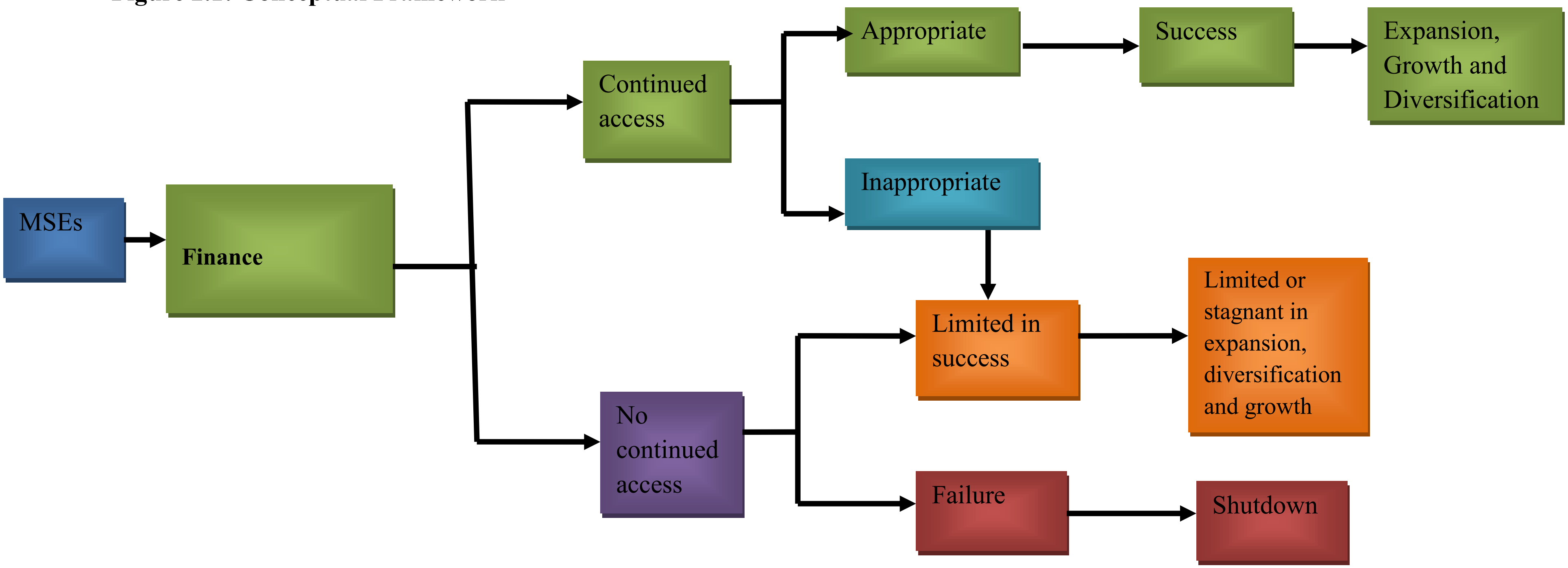
According to Molhotra *et al*. (2006), MSEs plays a pivotal role in developmental goals, such as in improving living standard, distributing income fairly among low level and high level group, reducing unemployment rate, fostering linkages among various economic sectors, easy to begin and expand, labor intensive, require small capital, low technology, and little know - how, this sector is receiving due attention of policy makers and development practitioners. Malhotra *et al*. (2006), Wattanapruttipaisan (2003) pointed out the role of MSEs in providing individuals with better job opportunities and facilitate the import and export transaction among countries. To create comfortable ground for MSEs, finance is the major determinant one.

Ideally, micro and small enterprises may use internal and external sources of finance. Internal sources of finance comprises own savings and retained earnings while external sources of finance includes security finance, explicit and implicit borrowing from formal and informal sources. However, micro and small enterprises cannot resort to primary and secondary money and capital markets due to such markets do not exist in developing countries including Ethiopia. In addition to this, raising funds through securities (bond and equity) issue involves listing requirements that are too stringent for many firms to meet, and is costly.

Gebrehiwot and Wolday (2006) stated that friends or relatives, supplier's credit, and Iqub (rotating saving and credit associations) are the most important sources of finance. Although finance is not everything, enterprises need finance to invest in new equipment and machinery, reach out to new markets and products, and cope with temporary cash flow shortages as well as to innovate and expand. Some authors argued that capital being scarce in developing countries should essentially be deployed in a way that maximizes the creation of new jobs and production of new goods and services rather than being used to convert a very small number of businesses into modern capital-intensive ones. However, available data on MSE finance is usually limited to access constraints to formal finance and their reliance on informal sources. The terms and conditions of the latter are simply assumed, rather than critically examined, in light of the needs and preferences of MSE operators.

According to Pissarides (2000), access to bank loans is virtually absent. The main reasons are their illegality or partial legality, lack of proper accounting; small size, therefore, high transaction costs for banks; firm mobility, leading to high moral hazard and risk of default from a bank's point of view. In order to borrow from formal banks, MSEs should bring mortgage able assets or collateral. This is the main problems of MSEs in obtaining finance. In addition to this Wattanapruttipaisan (2003) stated that lack of access to credit, shortage of credit period and collateral are acute financial constraint for MSEs in developing countries. Malhotra (2006), Beck (2007) and Vandenberg (2009) also raised this problem. In similar fashion, Pissarides (2000) stated that credit constraints constitute one of the main obstacles to growth of MSEs.

Figure 2.1: Conceptual Framework



Source; the Researcher's Framework

1.12. Empirical Studies and their Results

In this section, an attempt is made to assess the empirical studies conducted by different authors in different countries at different times. It deals with the hypothesis, research questions, method used to examines or test, finally it attempted to identify the findings of these authors.

Vandenberg (2009), who conducted his study in Zimbabwe, used stratified cluster sampling to conduct the research effectively; he prepared and distributed questionnaires to managers and workers of MSEs in Zimbabwe. The researcher also enriched the information using personal observation. The finding of the study indicates that finance highly influences the activities of MSEs in one way or another. The author also realized that governments and their policies should contribution to the success and effectiveness of MSEs.

According to Pcpherson and Rous (2006) who used their data from a survey of 858 MSEs in East Java, and they employed full information maximum likelihood approach known as discrete factor method.

The result of Pcpherson and Rous (2006) indicated that access to credit is not a significant to MSEs' growth. Instead, other observable and unobservable characteristics of MSEs appear to cause growth. In addition to this, the above authors stated that the policy maker's enthusiasm for MSEs' credit could be misguided while our data had some limitation. The authors seen no evidence that MSEs in this sample seem more likely to grow as a result of the sector in which they operate, their initial size and age, human capital that has communities in which they are locate. The point is that MSEs growth may do so for other reasons than access to formal credit.

According to the study conducted by Omohezuaun and Inegbenebor (2004) in Nigeria, the data used for this study were sourced from the Central Bank of Nigeria-sponsored baseline economic survey of MSEs in the seven Economic Zones of Nigeria. The survey gathered information on the characteristics of 6,663 MSEs.

The study showed that in the zones, MSEs relied on three main sources to finance their new investments. The three sources were retained earnings, loans from friends and relatives and loans from banks. Responding firms were further asked to rank their source of funds in order of importance. The study revealed that source of investable funds; in order of importance were retained earnings, loans from banks, loans from friends and relations, loans from government agencies, funds from MSEEIS, loans from co-operative and other sources. MSEs in Nigeria would be unattractive to venture capital operations such as the MSEEIS. The potential for rapid growth of the MSEs targeted by the scheme is low and only a small percentage of firms will ever be able to access funds.

According to Riba's (1999) study conducted in 4 least developed countries (Burkina Faso, Nepal, Samoa and Zambia), find out that access to the technology and skills development remains a key constraint for MSEs, as does access to credit. Addressing access to credit is a crucial component of coherent policy framework for MSEs' promotion. It is important for MSEs to be able to articulate their concerns and needs because their inability to do so deprives the government of inputs for policymaking.

The author also found that one of the major constraints of MSEs' growth was Market. Marketing should be given due importance in the provision of support services. In the area of MSEs' finance, there is a need to develop measures for encouraging financial institution to serve the MSE sectors. In addition to this, the author never forgets the collateral requirements continue to be an obstacle for MSEs.

Gebrehiwot and Wolday (2006) who conducted the research on this subject in Ethiopia point out that inadequate loan size, loan durations that do not match with the gestation periods and cash flow patterns of borrowers' activities financed by the loan, failure to disburse loans timely, and the tendency of group collateral requirements to exclude some microfinance borrowers are which hindering this achievement. The author also stated that trade credit is widely practiced among MSEs; that most of the trade credit-recipient MSEs lack access to bank loans; that MSEs receive trade credit are also likely to give trade credit (in effect, passing on the credit) and that MSEs mainly depend on single primary suppliers.

According to Geiger (2005), who conducted the paper in Turkey, found that financial crisis has experienced a sharp contraction of the amount of financial resources extended to MSEs. The commercial banks have been squeezed for lendable funds and also have experienced rising loan delinquencies. As a result, MSE lending has been cut back sharply. Halk bank the institution that is theoretically specialized in MSE lending has experienced a real contraction in lending; and lending to MSEs receiving special certificates to qualify for specialized programs has also declined. The author stated SMEs rely on informal finance, partly because on balance the larger banks and the capital market are structured to favor larger enterprises or state entities. With few prospects of access to external finance, the incentives to seek funding through the formal financial system are not strong (Atieno, 2009) who has investigated his study in Kenya on the nature of linkages between MSEs and financial institutions and how these impact on enterprise performance. The results show that small-scale enterprises have different, albeit limited, forms of linkages both among themselves, and with financial institutions. Such linkages include associations that help to mobilize and allocate financial resources among its members, informal groupings, and savings interactions with financial institutions. Linkages with financial institutions are evident as loans, mainly with MFIs, while interaction with commercial banks is limited to savings services only.

In similar fashion, Mulu (2007) who conducted the study based on a survey consisting 974 randomly selected businesses in six major towns in Ethiopia in this area stated that the smaller and younger firms grow faster than their counterpart. Growth rate also differs by sector, in which the enterprise operates. Manufacturing shows higher growth rate (13%) followed by service (11%) in contrast to trade (6.2%). The author also list out a wide variety of factors that might affect business growth. The author considered six broad categories of variables; sector, location, human capital, demographic factors, formality of the firm, and access to finance in addition to initial size and age of the firm.

Both initial size and age were negatively related with growth. Thus, it is an important task facing the country to raise the overall volume of lending to MSEs as well as to pursue policies to assist targeted categories of MSEs.

In conclusion, many authors who assessed finance as success or failure factor for MSEs in different angles. Some of the failures or financial constraints are lack of access to credit, Market and collateral requirements. There are other authors who oppose this opinion by saying that access to finance is not the major failure of MSEs rather term of loans (time duration). There are also other authors who share both ideas. If the knowledge gap is so, the role or the significant of this study has to see the difference in these authors (doubt). Moreover, the study has focused on the financial constraints of MSEs after establishment which are loan size, loan duration, time delays and the interest rate. The researcher has addressed these problems through interviews and questionnaires to MSE owners and managers of MSEs.

CHAPTER THREE

METHODOLOGY OF THE STUDY

A research method can be qualitative, quantitative or mixed. Creswell (2009) defined quantitative research as a formal, objective and systematic process in which numerical data are utilized to obtain information. Mmuya (2007) stated that qualitative research is an investigative methodology that is grounded in a philosophical position that focuses on making sense of the social world through a process involving how it is experienced, understood and interpreted. The qualitative approach is a set of complex relation involving individuals and groups of individuals. This method takes a theoretical and methodological focus on complex relations between personal and social meanings, individual and cultural practices and the material environment or context. Whereas, mixed research is characterized as the combination of both qualitative and quantitative research approaches.

Among the aforementioned approaches, mixed (more of qualitative and to some extent quantitative) approach is used in this research in order to address the research questions and thereby to investigate finance as success or failure factor for the growth, expansion, diversification and development of MSEs.

This research is both descriptive and exploratory since the study is aimed at investigating on how finance affects the growth, expansion and diversification of MSEs. To investigate the effects of finance, interviews and questionnaire have used that is more of qualitative (judgmental). In the quantitative approach, closed ended questions were used. From the qualitative approach, the researcher has used interview and questionnaire in order to get detailed investigation about the role of finance in expanding and diversifying MSEs. The questions were open ended for the qualitative one.

The research questions were formulated based on scientific literature review and then has tested by the survey. Questionnaires were distributed to MSE managers and owners. Semi-structured interview has also been used while conducting the study. The in-depth interview was conducted with official coordinator (Head Office) of MSEs. In addition to this, the researcher has conducted interview with each 10 woredas' MSE coordinators.

3.1. Sample Size and Sampling Procedures

According to the data obtained from Arada Sub-City (Head Office) of MSEs, MSEs are classified into seven categories based on their type of engagements. From the seven groups, the researcher has selected three sub-sectors based on their wide coverage in area and contribution to the GDP of the economy. They are Construction materials, Metal and Woodwork and Textile. By the time the study has conducted, out of 438 operators of MSEs, 28, 22 and 7 were selected from Construction materials, Metal and Woodwork and Textiles respectively. Consequently, a sample size of 20% from the 3 each sub-sector of MSEs or 57 MSEs have been selected from total population of 286. Stratified random sampling was used to address the problems in these sectors.

Questionnaires were distributed to each sample strata of the MSE sub-sectors to the managers and owners. 10 official coordinators of the MSE ten woredas have been interviewed. Meanwhile, the Sub-City head office coordinator has also consulted for further information.

To obtain the relevant information, judgmental sampling technique is used based on the position of the officials. Research instruments were translated in to Amharic language an administered to help respondents to clearly understand the questions.

3.2. Data Type, Data Sources and Data Collection Techniques

To conduct the research, both primary and secondary data has been used. The sources of primary data consisted of owner managers and legal officers (Bureau of Arada Sub-City) and the employees having access to the issue relevant to the research. The information has obtained through interviews and questionnaires.

The secondary data has collected on financial conditions, performance and growth of MSEs. The data collected include periodic publications of government body, documents on accessing credit facilities, initial and current capital and finally report on development of MSEs from the firm themselves and head office of Arada Sub-City.

Creswell (2009) stated that semi-structured interview is important, because, a set of sub-topics can be identify before the interview and it can also formulate questions during the interview after observing the interviewees' response. Besides, the researcher has used semi-structured interview which provides a great flexibility in asking questions. Hence, the interview was not constrained by rigid questions and allows the interviewee to elaborate on a topic which enables the researcher to get a better understanding about the role of finance for MSEs' development.

3.3. Data Processing

In processing the data, filled and completed questionnaires were carefully checked to assure that the data is accurate and uniformly entered and arrange to facilitate percentages and tabulation systems.

Coding data were made by assigning symbols to the response of the population and to group into limited number of categories. To arrive at the percentages and tabulations, the researcher has used both Excel and SPSS as a tool in order to incorporate into a document or research presentation.

3.4. Data Analysis

The data has been analyzed using tabulations that is in the form of tables, percentages, bar graphs, pie charts and finally with statements. These instruments help to facilitate the interpretation process of the research.

CHAPTER FOUR

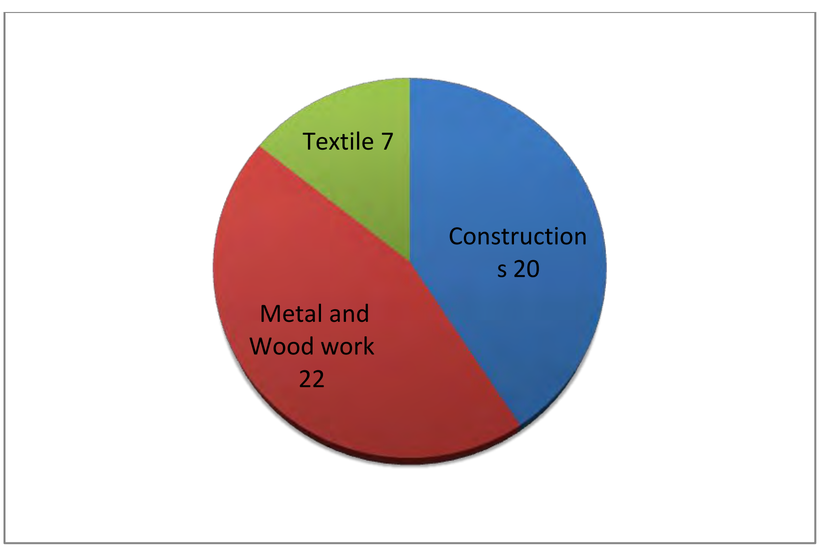
DISCUSSION AND ANALYSIS

4.1. Position of Respondents, Types and Numbers of MSEs

This discussion and analysis is based on the questionnaires distributed to the three types of micro and small enterprise managers and owners namely, Construction materials, Textile, Metal and Woodwork.

Meanwhile, the respondents of the interview were the government officials of the ten woredas and the head officer, who are assigned by the government to coordinate MSEs. The respondents were selected based on their positions. Total of 57questionaires were distributed to 57 MSE owner managers out of which, 49 questionnaires (86% response rate) were collected. The remaining 8 questionnaires could not be collected due to lack of cooperation.

Figure 4.1: Types and Numbers of MSEs

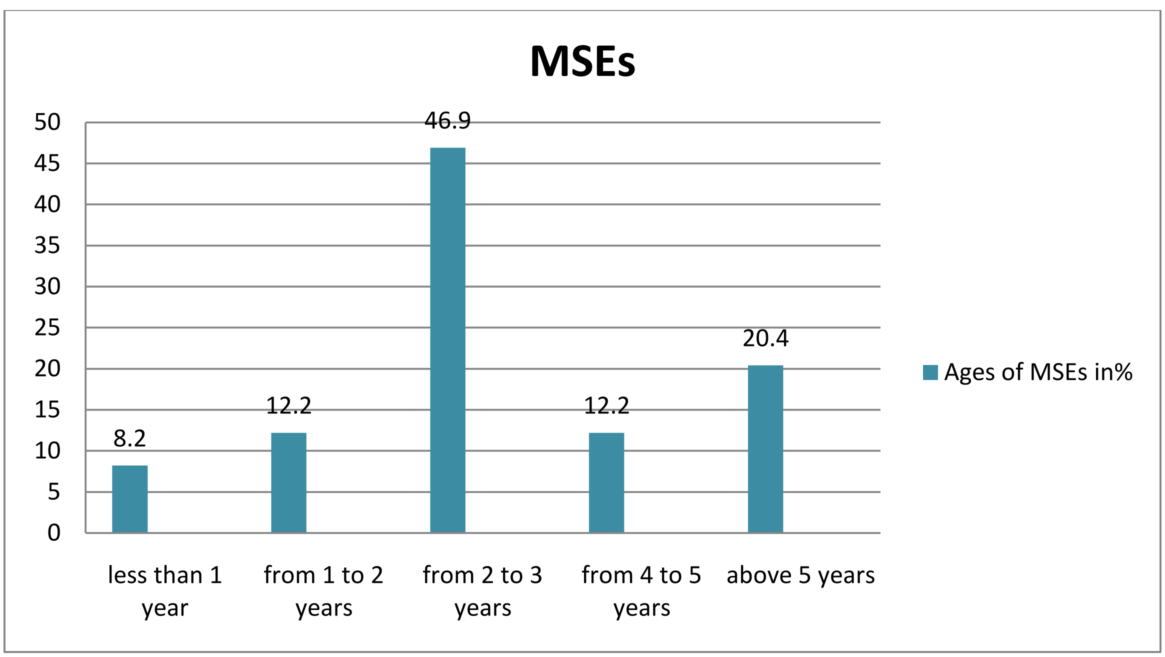


As indicated in the above Pie chart, the types and numbers of MSEs on which the research has conducted are three consisting of 20 Construction materials, 22 Metal and Woodworks and 7 Textiles.

4.2. Age of Micro and Small Enterprises

From the informants, it was possible to identify that many MSEs have been started since the past recent years. The following Bar chart indicates the ages of MSEs.

Figure 4.2: Ages of MSEs



From the respondents of micro and small enterprise owners, it was possible to indentify that the total number of MSEs under the study having an age of less than 1 year was 8.2 %. The majority (46.9%) of the respondents replied that they started their enterprise in between 2 and 3 years. This indicates there was good incitation during this period. The incitation was both from the jobless individuals and the government coordinators of MSEs. Moreover, many MSEs were late started. Similarly, 12.2% of MSEs have been waiting in the operation in between 4 to 5 years. Other 20.4% of MSEs have stayed more than five years in the businesses environment. The remaining 12.2 % of the respondents responded that their businesses have been started in between one to two years.

4.3. Motivation or Incitation of MSE Owners to Start the Business

To start a business, you should have an idea about the business. The idea could come from self initiation, families, friends and relatives and government offices (Woredas and Head office). In Arada Sub-City, the numbers of MSE operators are considerably increasing from time to time. In the Sub-City, MSE coordinator offices played a pivotal role in organizing MSEs.

MSEs are very important for developing countries. In the recent period, the government of Ethiopia is giving an emphasis for MSEs due to their importance. Accordingly, in the growth and transformation period, MSEs are expected to play a significant role. Moreover, MSEs are playing an important role in catalyzing the growth of production and exports and in creating employment opportunities. Finally, MSEs are the engine for economic growth and employment in many regions of the country. Therefore, policies and initiatives of the country focused on how to develop MSEs and to increase their competitiveness.

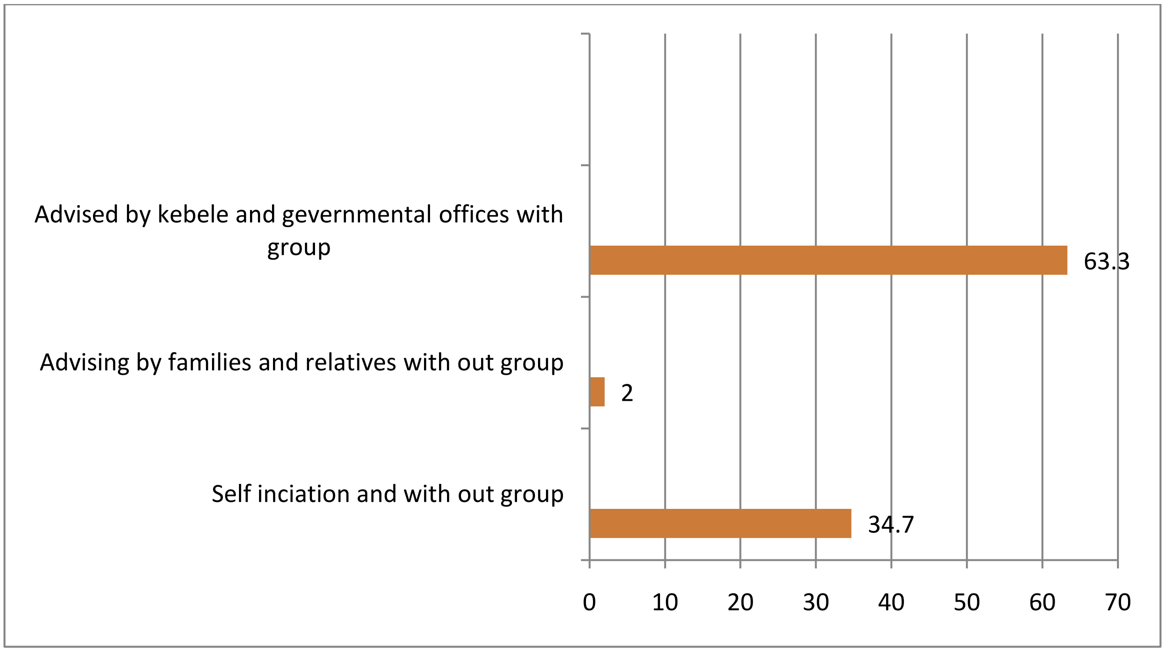
As per the annual report of 2002 of the head office of Arada Sub-City, currently, to organize one MSEs, it takes from 2 to 3 hours. But so far, in the Sub-City, it consumed many hours to organize one MSE. The newly introduced ways of organizing saves time comparing to the old one. In addition to this, the office provides training on how they manage and finance their organizations, bookkeeping, marketing, work place, raw materials and in solving disputes among the members.

To satisfy customers, the office is working a lot in collaboration with the owners and other governmental bodies. The office creates job opportunities for many youngsters who were jobless before.

Although the office has made many tasks to satisfy customers, but still, there is complaint from some customers. Some of the complaints offered by the customers were work premises (work place) and lack of utilities such as electricity and water. To solve these and other related problems, the office has changed its organizational structure and formed a committee. The committee has its own plan to fulfill the assigned responsibilities. Now, it shows a good improvement. Accordingly, the office has offered training on how to start a business and to access a finance to operate and expand their enterprises. Therefore, in the Sub-City, since the past recent few years, the numbers of MSE in the market have shown a good increment.

The following Bar chart shows how many of SMEs are advised and motivated by themselves without group formation; families and friends without group formation; and woredas and head office.

Figure 4.3: Motivations of MSE Owners



As indicated in the above Bar chart, 63.3% of MSE operators are motivated and organized by Kebeles and head office of the Sub-City. This implies that the kebeles and head office of MSE coordinators were playing a significant role in motivating and organizing MSEs. But, the motivation was not enough or satisfactory, because many youngsters are still jobless.

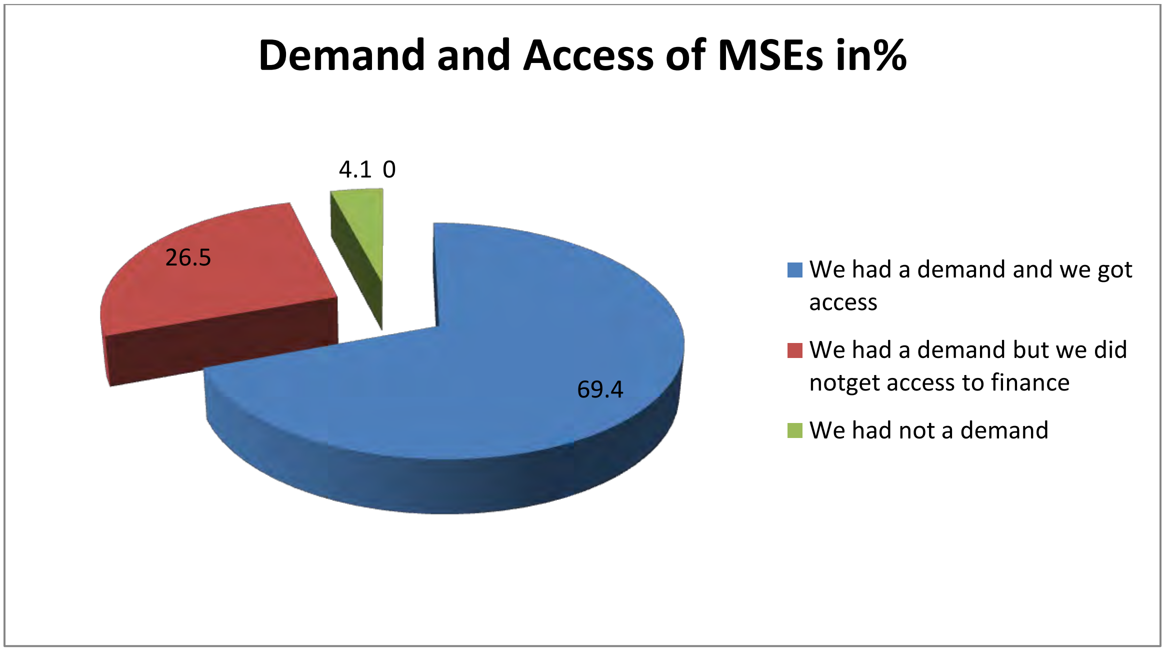
Whereas 34.7% of MSE owner managers replied that they initiated themselves without any advisor or group formation. In addition to this, they stated that they were committed to overcome their problems by themselves. Finally, a very few MSE owner managers (2%) revealed that they were advised by their families and relatives. From this, it is possible to understand that the efforts made by the Sub-City and their families to encourage MSEs are not enough. So, the office should work more and more to motivate the societies in order to engage in this sector.

4.4. Demand for Finance and Accesses of MSEs

Finance is the backbone of any business enterprise, including MSEs (Mckernan and Chen (2005). Hence, MSEs are part and parcel of business enterprise, capital is crucial for MSEs. This indicates that finance is the success, limited success and failure factor for MSEs' growth, diversification and expansion. Almost all MSEs have a need to get access to finance whether from their families, friends*, Ikub, Idir* or in terms of credit from microfinance and other banks. However, when we see in the ground, they are lacking access to finance. When we compare the demand they need to finance their enterprise and the supply they actually accessed, there is gap. If there is shortage of access to finance, the degree of expansion, diversification and growth of MSEs will also limited. OECD (2006) stated that financing gap (the demand and supply) is seen as the most common problems of MSEs.

Besides, owner managers have asked whether there is a gap between their demand and the actual access to finance they received. The response is presented by the Pie chart as follows:

Figure 4.4: Demand and Access of MSEs



As can be seen from the above Pie chart, the majority (69.4%) of the respondents of owner managers of MSEs responded that they had a demand to finance their MSEs and got the access to it. This implies that they are able to access the finance in accordance to their demand. They further revealed that there is no gap between the desired needs and the actual supply they received. However, 26.5% of the respondents responded that they had a desired to get finance to expand, diversify and buy raw materials but they were unable to get access to finance. This is because they failed to provide the requirements asked by the lenders. Some of the requirements are:

- ✓ Collateral
- ✓ They were asked to form a group and to be a guarantor to each other

In line with the above arguments, some owner managers stated that still the problem of access to finance is unsolved. On the other hand, 4.1% did not have a desire to get access to finance from somebody else, because they have sufficient capital to run their business.

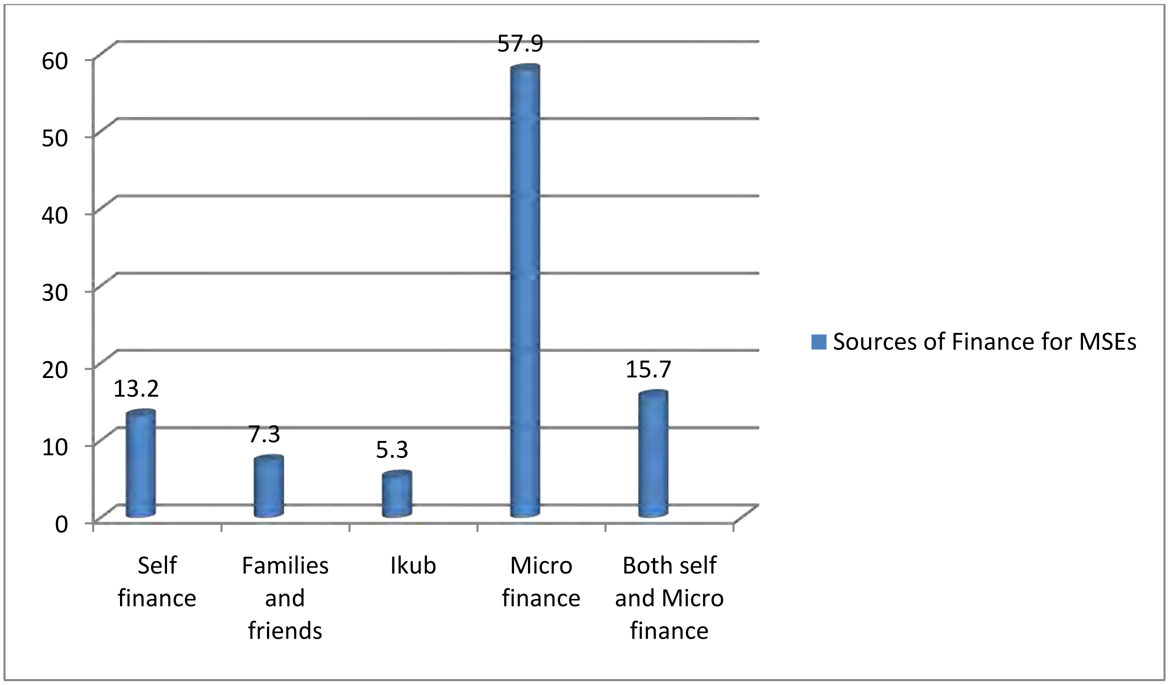
Moreover, it was possible to identify that there were many times that MSEs failed to operate the plan of their enterprise due to lack of access to finance at the right time.

4.5. Sources of Finance to Expand and Diversify MSEs

Finance plays a pivotal role to establish and operate MSEs. Funds are used to acquire and utilize modern technology, purchase critical raw materials and it makes the business to be bipedal. The sources of capital can be raised from multiple sources. A business can use internal or external funds to finance their operations and investments. A firm can use one of the two financing sources or both of them. Similarly, some MSEs could generate the sources of finance from their own capital (personal saving, retained profit and sales of assets), debt, *Ikub*, family, *Arata* and other source.

Accordingly, owner managers of MSE were asked their source of finance. The result of this analysis and discussion is indicated by the Bar charts as follows:

Figure 4.5: Sources of Finance



As indicated in the above Bar charts, 57.9% MSEs have raised their finance from microfinance institutions which are from Addis micro finance. By using this fund, MSE operators were expanding, diversifying, and promoting their business in the Sub-City. After MSE owners received the money from Addis micro finance, they used to purchase raw materials and for other operation of their business.

According to the owner managers, 13.2% of MSEs have raised from self financing only. It is not to mean that their own capital is enough rather due to their failure to get access to finance at the right time from other sources. In addition to this, some respondents replied that since most of MSEs are financially weak, many of the financial institutions (creditors) were not willing to lend them. As a result, they lacked access to finance from other sources. So, the only alternative they did is to use their own capital.

In similar fashion, some MSEs also raised finance from their families and friends. As per the respondents, 7.3% of MSEs obtained from their families (father, mother, sister, brother and other bloodily related bodies) and friends. In connection with this, 5.3% of MSEs have acquired from *Ikub*, whereas 15.7% generated from both self and microfinance institutions. None of the respondents replied that the sources of their finance were from banks and NGOs. This implies that large banks were not willing to lend MSEs due to fear of repayments.

In addition to this, after they received the finance from the above mentioned sources, they used it to:

- Expand and strength their existing enterprise (expansion)
- Diversify their business, in addition to the existing one
- Purchase raw materials and
- House rent

4.6. Conditions of Borrowing

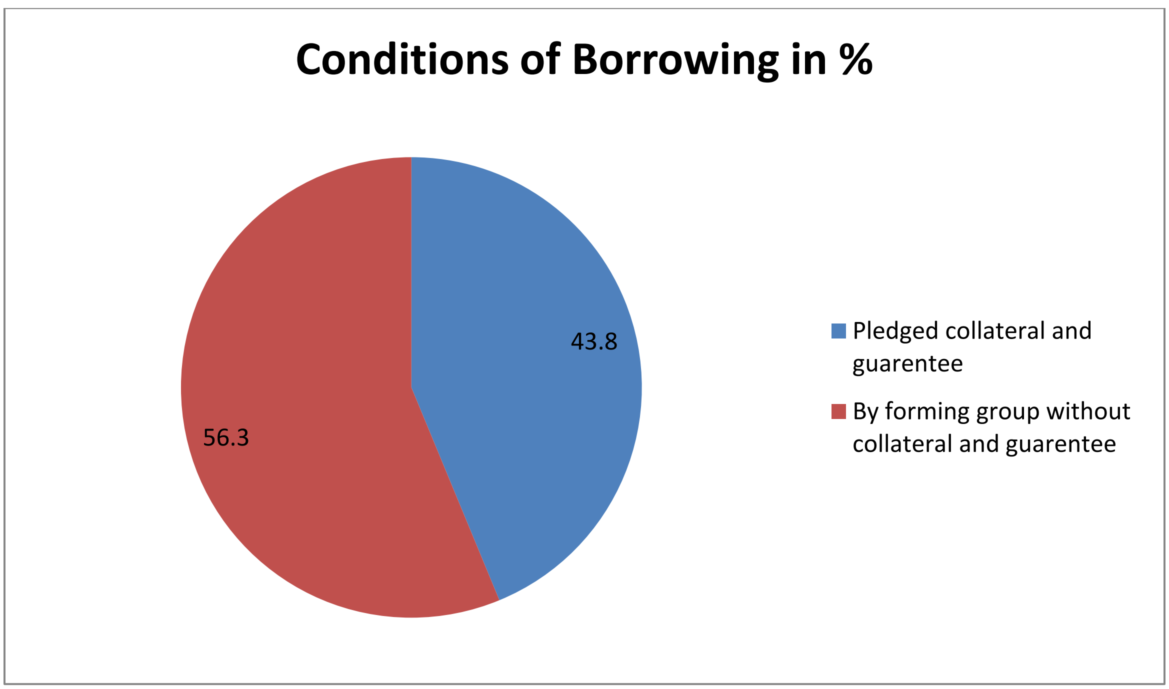
Most of financial institutions that have a surplus capital want to lend to different institutions, including MSEs and people who have shortage of capital. To lend their money, financial institutions set their own requirements. Some of the requirements are:

- **Collateral**-borrowers are asked to pledge asset such as house, land, cars and other assets having a considerable value.

- **Guarantee-**borrowers should bring guarantors having considerable monthly income.
- **Loyalty**- to get the money, borrowers should be loyal in repaying the principal and interest amount at the specified period.

These requirements were difficult for some MSEs for the fact that it deterred them to become credit users of financial institutions thereby to expand and promote their business**.** Hence, owner managers of the selected MSEs were asked the preconditions of borrowing and the responses of the respondents are manipulated as follows:

Figure 4.6: Conditions of Borrowing

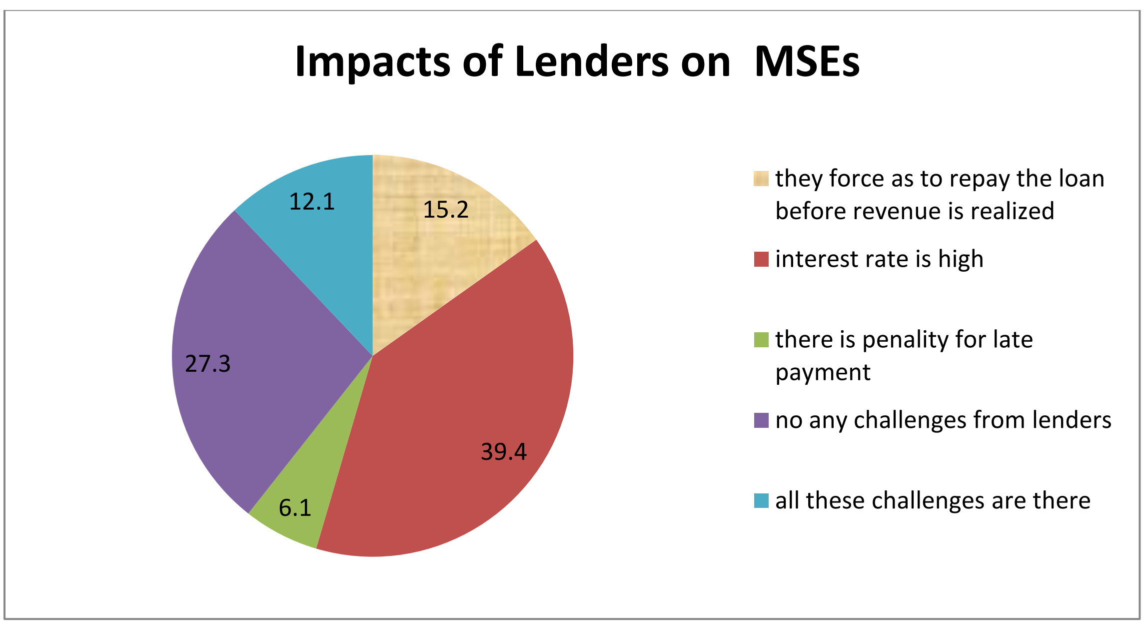


As indicated in the above Pie chart, 56.3% of the owner managers of MSE replied that they did not asked to bring collateral but they ordered them to form a group and to be guarantor to each other (group guarantee). The remaining 43.8% of the respondents also displayed that they ordered to bring both collateral and guarantors.

4.7. Impacts of Lender on MSE Owners

Lenders have their own rules and regulations to manage their clients. Some lenders or creditors are stringent in their credit policy and ask their clients to pay penalties if they pass the due date. On the other hand, some creditors charged high interest rate while others are fair in treating their customers that they would not force to pay penalty for late payment and charged fair interest rate. Accordingly, owner managers of MSEs were asked the impacts of lenders on their business and the response was as follows:

Figure 4.7: Impacts of Lenders on MSE Owners



As can be seen in the above Pie chart, most (39.4%) of the owner manager of MSEs replied that the challenge was interest rate. The interest rate that MSEs were charged and the financial capacity of MSE owners did not match. Since the income of MSEs is not as such high, their headache was interest rate.

In opposite fashion, 27.3% of MSE owner managers stated that there was no negative impact from the credit providers rather own and interrelated problems. In addition to this, they stated that there was fair interest rate, medium time duration for repayment of the loan and no penalty for late payments. Whereas, 12.1% of the respondents stated that:

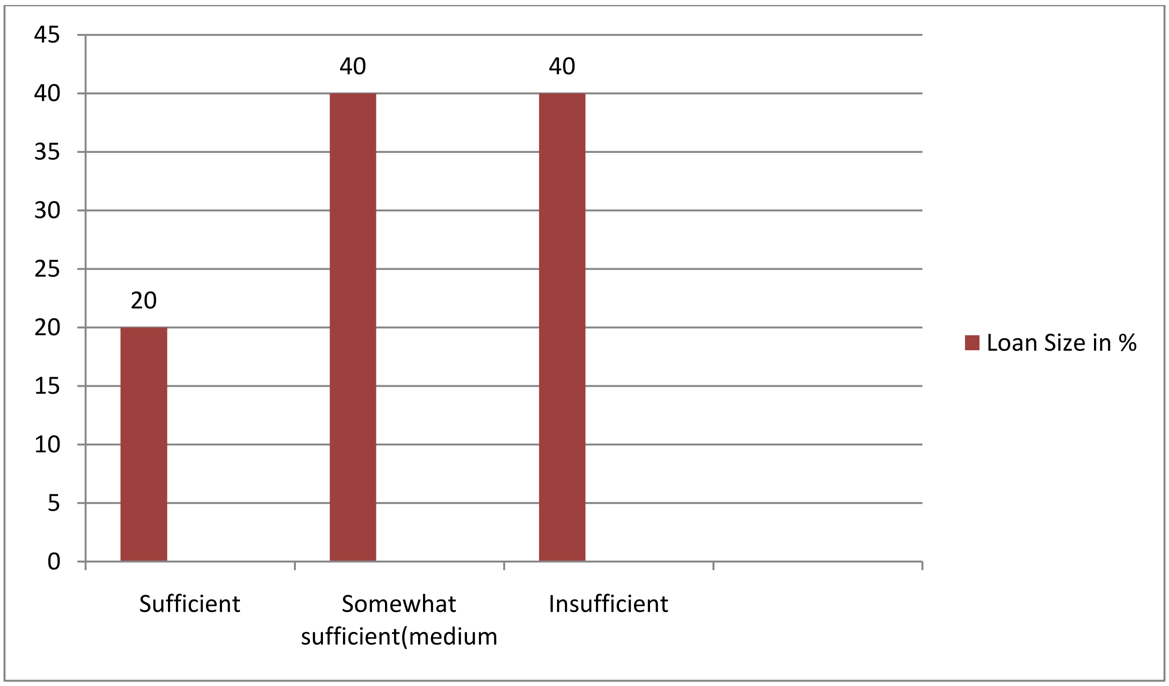
- They forced them to pay the loan before revenue is realized,
- There was unfair interest rate comparing with their income
- There was penalty for late payments
- And they lost access to credit for other time since creditors believed that they are financially weak and not loyal.

Some (15.2%) of the respondents stated that there was only short term loan. But, they agreed with the fairness of the interest rate and penalty for late payment. The remaining 6.1% of the respondents disclosed that there was penalty but the other conditions are comfortable with their enterprise.

4.8. Loan Size of MSEs

Owner managers have been asked the loan size of their enterprise and the response was as follows:

Figure 4.8: Loan Size



As indicated in the above Bar graph, only 20% of MSE owner managers borrowed sufficient amount. This is due to their loyalty in repaying the loan, long period relationship between them and other safety of collateral and guarantee related things. This indicates that there is restriction to borrow money. This in turn impeded the expansion and diversification of MSEs. Moreover, 40% of MSE respondents responded that they borrowed insufficient amount of loan due to:

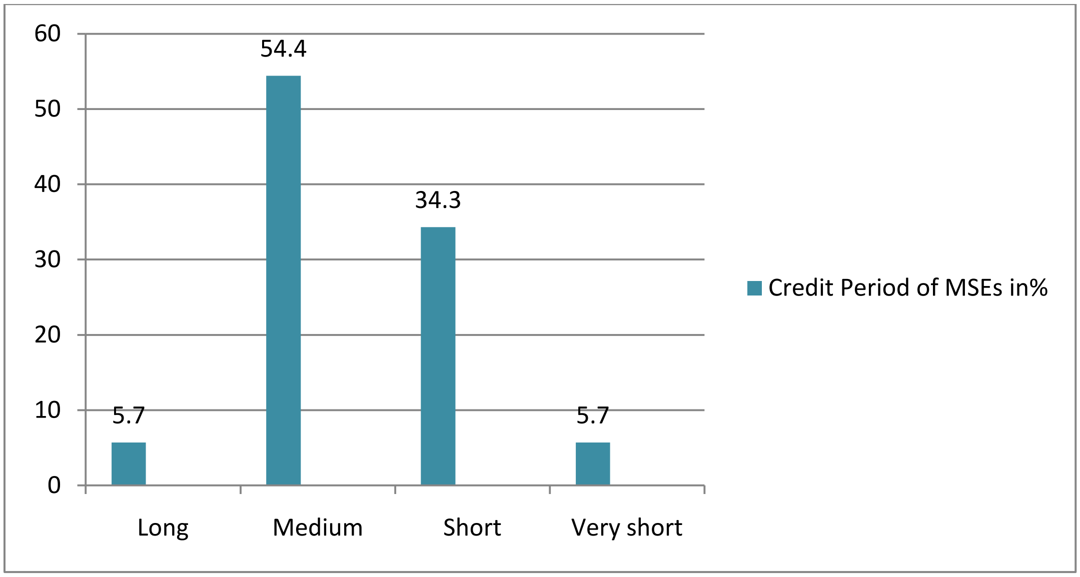
- Loan restriction
- Fear of interest rate

Moreover, the remaining 40% of MSE respondents replied that they borrowed somewhat sufficient but still insufficient. This happens because the creditors were not willing to disburse the amount of loans asked by borrowers. Conversely, some MSEs lacked willingness to take sufficient loan size due to their fear of risk in repaying the amount and high interest rate.

4.9. Credit Periods of Loans or Terms of Loans

Many MSE owners of Arada Sub-City, who are in the form of group, are users of credit from Addis microfinance institution. Addis microfinance provides different terms of credit based on the agreements of both parties. The agreement includes length of credit term, interest rate, and ways of repayment for both the principals and interest rates. In principle, there are three types of credit terms, which are short term, medium term and long term credit periods. Besides, some of MSE owners are users of these credit terms. Accordingly, owner managers of MSEs have been consulted in order to discuss about the terms of loans and they responded as follows:

Figure 4.9: Credit Term of Loans



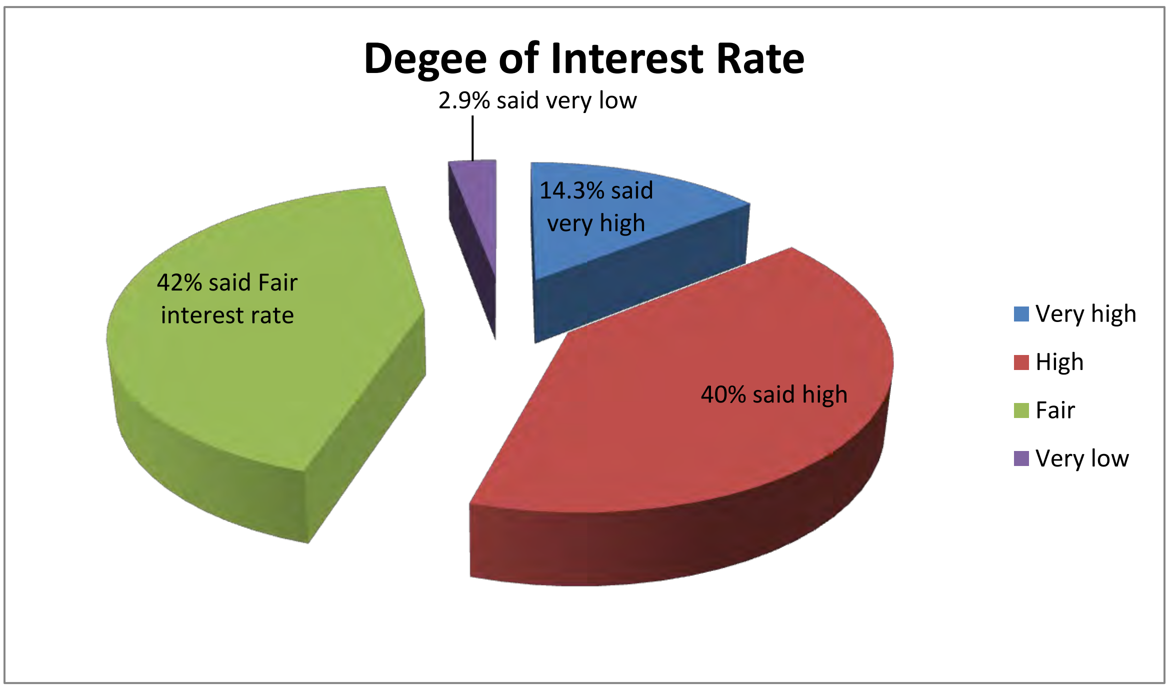
Out of the assessed MSEs, only 5.7% of the owner managers elaborated that the credit periods were long. This encourages MSEs to expand, diversify, promote and thereby to increase the status of their financial condition. The majority (54.4%) of the respondents stated that they do not have a problem with the time duration.

Conversely, 34.3% of MSE respondents stated that the duration of the credit was short. While 5.7% disclosed that the credit period was very short. In addition to this, they responded that the credit providers didn't wait them until they generate cash inflow (revenue). Seasonality of market affects negatively or positively for the product they produce and thereby the income generation periods. For example, the products of Textile (Cloths) are highly needed during holidays and the opposite is true in other days. As a result, this fluctuation affects the ability to repay the loan.

4.10. Degrees of Interest Rate

The degrees of interest rates are different from institutions to institutions. To know the degree of interest rate, MSE owner managers have been asked about the interest rate imposed on them by credit providers and the response of them is indicated in the following Pie chart.

Figure4.10: Interest Rate

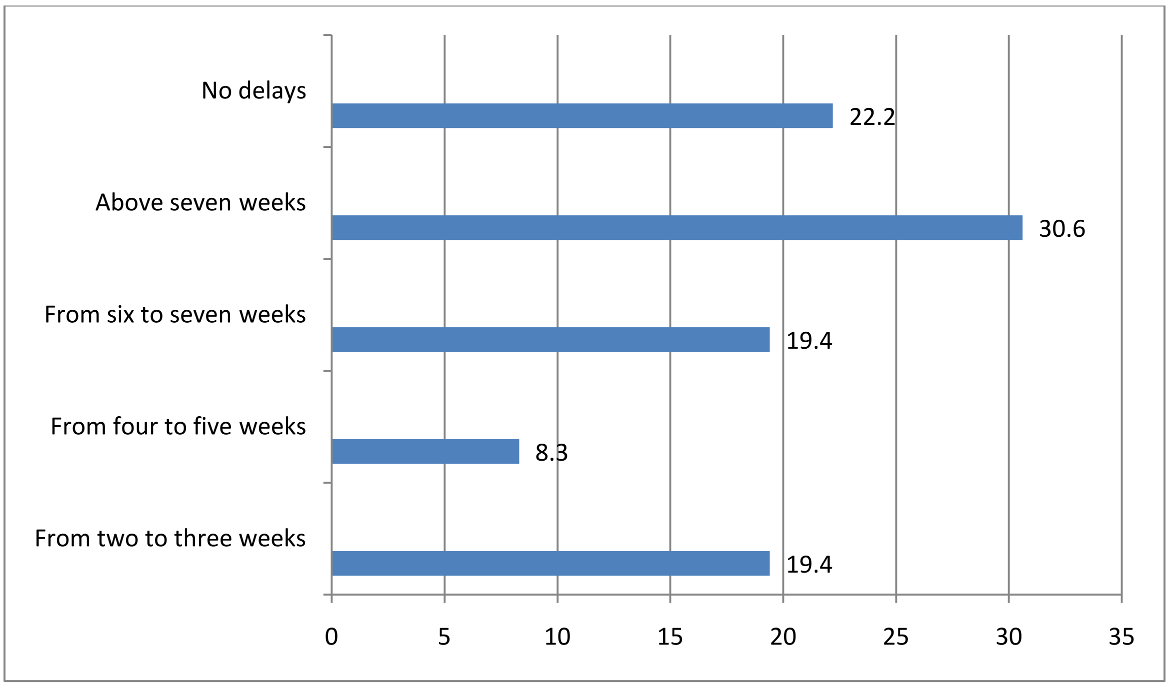


As can be seen from the above Pie chart, 54.3% of the owner managers responded that the interest rate is high or very high to bear and 42% of the respondents stated that the interest rate was fair. Whereas, the remaining 2.9 % elaborated the interest rate was very low.

4.11. Delays of Fund from Credit Providers

To create employment opportunities, the government is attempting to provide suitable conditions on how to run and get finance. In providing the finance, some lenders are disbursing the money without considerable delays while others are not disbursing the money at the right time. Accordingly, to investigate the time delays, respondents have been asked about the time delays and their response was as follows:

Figure 4.11: Time Delays in %



From the above Bar chart, we can observe that the majority that is about78% indicated that there is time lag between the date of request and the time funds are released. They responded that the waiting time extends from two weeks to over seven weeks that is (19.4% from two to three, 19.4% six to seven and 31% above seven weeks). Divergently, 22.2% of MSE respondents stated that there is no considerable time delay.

Although some respondents tended to indicate the absence of time lag between the request and disbursement of loans, majority of the respondents agreed that there were time delays which adversely affected the expansion, diversification and growth of their business.

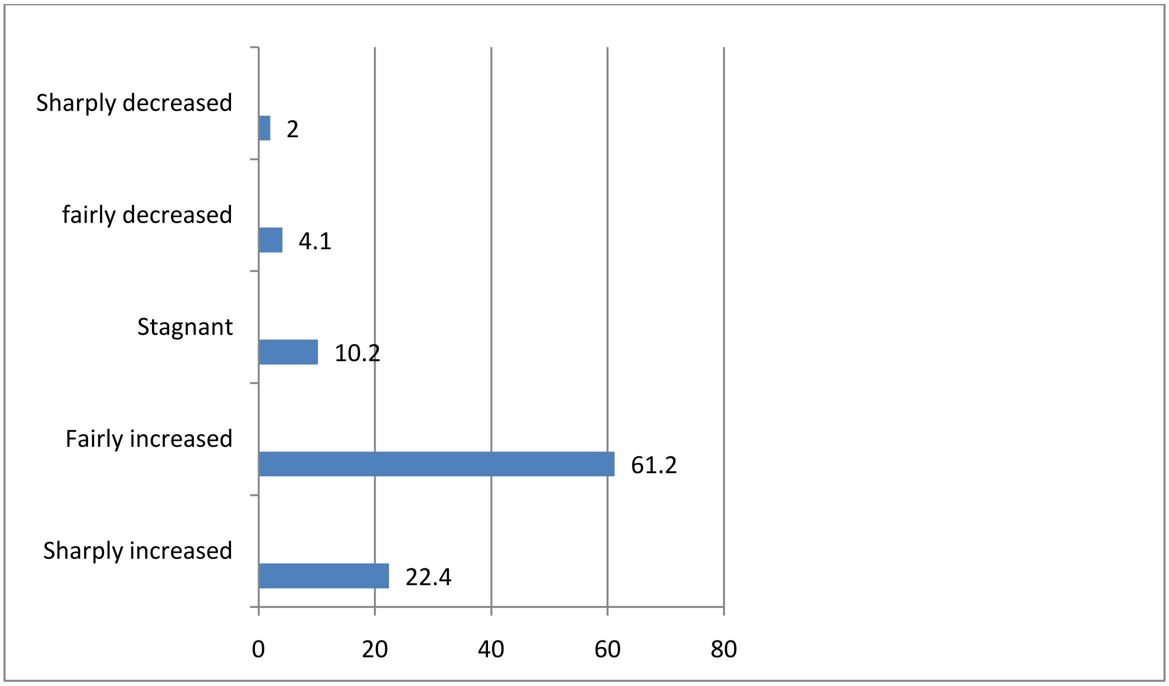
4.12. Financial Capacity of MSE

The financial capacity of MSEs would differ from one to another. This is could be due to some enterprises are strong in every activities while others are weak. Financial capacity is dynamic which changes through time. Some MSEs financial condition changes positively, some remains static, while others changes negatively. According to OECD (2006), this happen due to:

- Their willingness to work effectively
- Availability of access to finance
- Market condition to sell their products
- Availability of raw materials
- Legal restrictions and taxation
- Availability of work premises (work place)
- cooperation among member
- Level of infrastructure
- Transaction costs
- Skill of managerial and technical expertise

The above listed points, directly or indirectly, affect the financial condition of MSEs. Besides, MSE owner managers have been asked the financial conditions of their enterprise and the response was indicated by the following Bar graph.

Figure 4.12: Financial Capacity of MSEs in %



As indicated in the above Bar chart, 22.4% of MSEs financial condition[5] is sharply increasing. On the other hand, the majority (61.2%) of the respondents stated that the financial status of their enterprise is fairly increasing from time to time, while 10.2% of MSEs financial condition remains stagnant or constant.

In opposition to the above paragraph, 4.1% of the owner respondents replied that the financial condition of their enterprise was fairly decreased. In addition to this, 2% of MSE respondents have responded that the financial status of their enterprise is sharply

[5] Financial condition in this case refers to capital of MSEs.

decreasing. They also stated that they are operating this enterprise only for survival (consumption) purpose.

To strength the above arguments, the researcher was interested to add the audited capital of some of the three selected sectors of 49 MSEs. The following Table indicates the initial and current capital of MSE.

Table 4.12: Capital of Some Selected MSEs

MSEs	Initial Capital	Current Capital	MSES	Initial Capital	Current Capital
MSE 1	2,100	3,000	MSE 26	1,000	10,000
MSE 2	200	5,000	MSE 27	40,000	80.000
MSE 3	1,000	50,000	MSE 28	980	20,000
MSE 4	220	5,00	MSE 29	42,000	205,000
MSE 5	500	5,000	MSE 30	20,000	60,000
MSE 6	500	9,000	MSE 31	7,000	20,000
MSE 7	70	5,000	MSE 32	15,000	20,000
MSE 8	1,500	10,000	MSE 33	5,000	10,000
MSE 9	700	900,000	MSE 34	29,000	50,000
MSE 10	21,000	150,000	MSE 35	550	45,000
MSE 11	23,000	120,000	MSE 36	5,000	25,000
MSE 12	1,900	15,500	MSE 37	20,000	30,000
MSE 13	40,000	250,000	MSE 38	20,000	35,000
MSE 14	2,200	50,000	MSE 39	10,000	20,000
MSE 15	12,000	600,000	MSE 40	5,000	20,000
MSE 16	1,250	90,000	MSE 41	5,000	15,000
MSE 17	55,600	10,000	MSE 42	12,000	25,000
MSE 18	1,000	1,000	MSE 43	4,300	55,000
MSE 19	1,300	1,300	MSE 44	2,500	2,500
MSE 20	500	500	MSE 45	2,000	1,200
MSE 21	1,000	5,000	MSE 46	360	1,900
MSE 22	1,500	100,000	MSE 47	100	120,000
MSE 23	1,000	2,000	MSE 48	500	20,000
MSE 24	1,000	10,000	MSE 49	2,500	35,000
MSE 25	2,000	80,000			

Sources: Arada Sub-City Head Office (Sep.2009)

To assess the financial conditions of MSEs, it was interesting to see the capital of 49 MSEs which are 20, 22 and 7 from Constructions materials, Metal and Woodworks and Textiles respectively. From the above Table and responses of the owner managers, the researcher concluded that most of MSEs' capital is positively changed or going up.

4.13. The Impact of Finance on the Success of MSEs

Theories stated that finance is determinant for the success of MSEs. This reveals firms having access to finance are most likely to success. To know the relationship between access to finance (independent variable) and success (dependent variable) of MSEs, the researcher was interesting to see the correlation of lack of access to finance and success of MSEs and the result is indicated in the following Table.

Table: 4.13. Correlation between Lack of Access to Finance and Success of MSEs

		Sources	Success
Sources	Pearson Correlation	1	-.462(**)
	Sig. (2-tailed)		.004
	N	38	38
	Pearson Correlation	-.462(**)	1
Success	Sig. (2-tailed)	.004	
	N	38	49

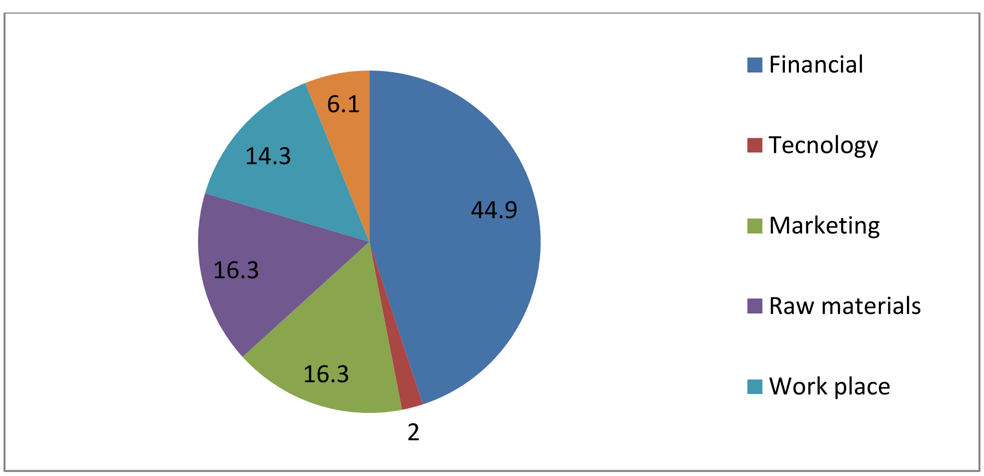
** Correlation is significant at the 0.01 level (2-tailed).

As it is clearly shown in the above Table, the result displays a negative relationship between lack of access to finance and success of MSEs. That is firms having better access to finance are more likely to success and firms which lacked access to finance are most likely to fail. This supports the theories which are found in the hypothesis and review of literature. In other words, an appropriate access to finance has a positive correlation with success of MSEs. Moreover, it is possible to identify that lack of better access to finance and success of MSEs is significantly (at1% level) negatively correlated (- .462, see the above Table). Generally, the negative correlation indicated that there is lack of access to finance which hinders the growth, expansion and diversification of MSEs.

4.14. Major Problems of MSEs

The hindrances of one enterprise may not similar with the hindrance of other enterprise. Some of the hindrances of MSEs may be finance, raw material, technology, marketing, know-how, work place, utilities (electric city and water) and other related problems. Among these alternatives the researcher asked owner managers to indicate the major problem of their enterprise and the responses of the respondents were as follows:

Figure 4.14: Major Problem of MSEs in %.



The majority (44.9%) of the MSE respondents stated that the major hindrance to expand and diversify their enterprise was lack of finance. It is clearly known that if there is lack of finance, MSEs do not expand and promote as expected.

Some (16.3%) of them replied that marketing was the main problem, while 16.3% of the respondents indicated lack of raw material. Meanwhile, 14.3 %, 6.1% and 2 % of the respondents revealed that lack of work place, both finance and market and technology were the major problems of MSEs respectively.

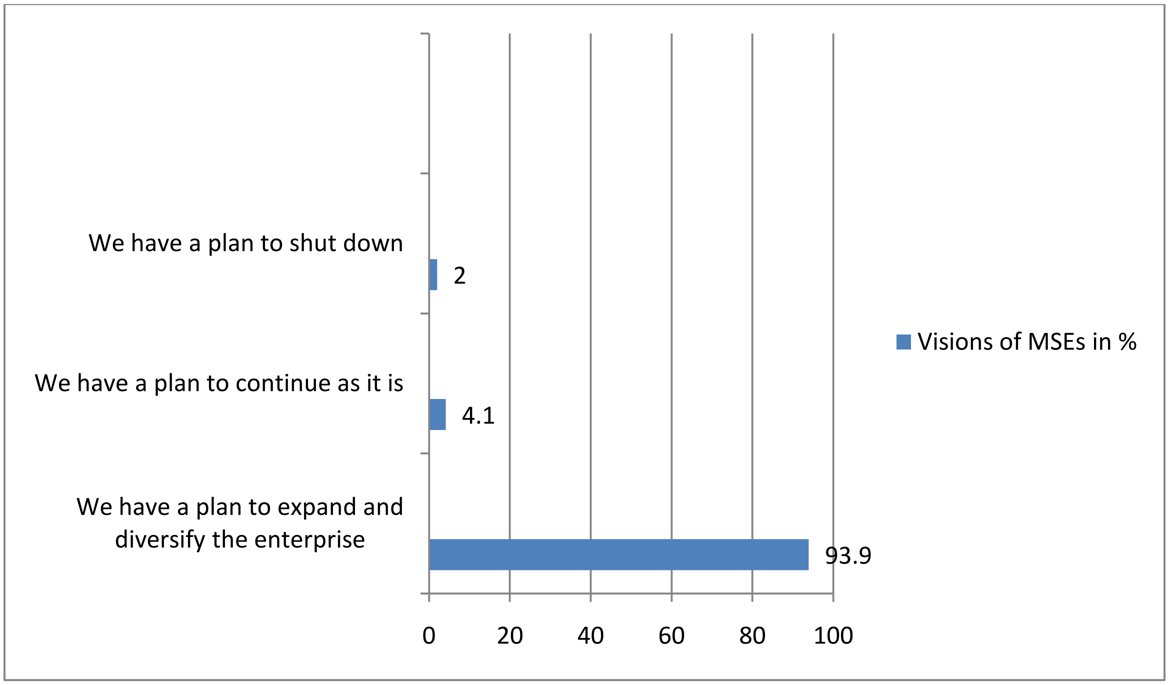
4.15. Vision of MSEs to Expand and Diversify their Enterprise

Since MSE owners aimed at improving their living standard in particular and the country in general, they are attempting to survive in the business. The advantages of surviving MSEs in the business are:

- Reducing unemployment rate
- Serving as an ancillary to the medium and large enterprises.

Therefore, MSE owners want to wait in the market unless they faced very challengeable problems. To know the vision of MSE owners, the researcher asked the owner managers about the plan of their business enterprise and the responses of the respondents are indicated as follows:

Figure 4.15: Vision of MSEs

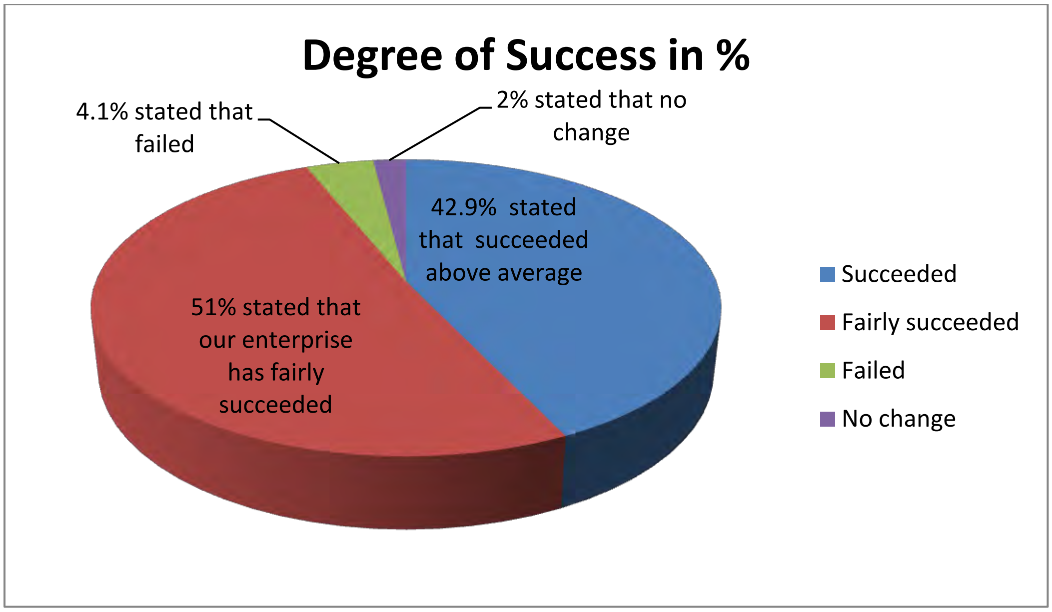


As indicated in the above Chart, almost all (93.9%) of MSE owners have a vision to expand, diversify and promote their business in the future. In opposite fashion, 4.1% and 2% of MSE owners have a vision to continue as it is and to shut down their enterprise respectively.

4.16. Success of MSEs

When any one engages in any activity, he or she could be successful, stagnant or fail. Likewise, MSEs have also the same probability. Accordingly, to know how many of MSEs are on the truck of success, owner managers have been asked in relation to their success and the responses of the respondents is displayed in the following Pie chart.

Figure 4.16: Success of MSEs



As indicated in the above Pie chart, the majority (51%) of the owner managers stated that their enterprise was fairly succeeded, while 42.9% of them elaborated that their enterprise was succeeded above average.

In a different way, 4.1% of the respondents of the enterprise replied that their enterprise is failed, and the remaining few percentages (2%) indicated that their enterprise has shown no change. In addition to this, owner managers have also been asked how they measure the degree of success for their enterprises. Accordingly, some of them they measured by:

- ✓ **Revenue-** simply focused on the sale volumes of their enterprise.
- ✓ **Net profit-** measured by net profit after total expenses is deducted from total revenue.

- ✓ **Capital-** if they retain the profit in the business.
- ✓ **Number of employees-** if the number of employees is increased.
- ✓ **Work of the enterprise**-if the enterprise is expanded and diversified.

4.17. The Role of the Government in Supporting MSEs

Interview was made with officers of micro and small enterprise development Bureau of the 10 woredas and the head office of Arada Sub-City. It was possible to identify that government is working towards facilitating access to finance for micro and small enterprises. The coordinator officers were assisting micro and small enterprises by providing work areas (industrial place) when they start their activities or operations. As per the respondent of the head office, the researcher has able to identify that in the Sub-City, there are industry areas provided for MSEs.

In addition to this, the Bureau has been giving training for MSE operators. These training contains on how to:

- ➢ Raise funds to finance their enterprise
- ➢ Maintain bookkeeping
- ➢ Sale their products, where and when
- ➢ Produce unique and new products
- ➢ Solve conflicts among the group members and other related issues.

On the other hand, the respondent of the head office replied that the Sub-City maintain database of MSE operators, consists of name and address , the initial and current capital along with the number of MSEs closed down with their reasons. Lack of work place, disagreement among group members and changing of work place from Addis Ababa to Afar are some among the major reasons of closing down of MSEs. 4 Constructions materials and 8 Textiles of MSEs are cases in point. As per the head officer of the Sub-City, however, no enterprise is closed due to lack of finance.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter presents major summary of the findings, conclusion and recommendations.

5.1. Major Summary of the Findings

Based on the analysis and discussions which is presented in chapter four, the researcher has pointed out the major findings of the study.

Finance is crucial for business activities. It is used to start up, growth, expand, diversify and for working capital of the MSEs. Without finance, it is difficult to achieve the objectives of MSEs. Moreover, finance helps MSEs to expand, diversify, promote, innovate, growth and thereby to compete in the market. However, in the Sub-City, some MSEs found out that they did not have enough finance to accomplish their objective. The study has conducted on three types of MSEs. That is Construction materials, Textiles and Metal and Woodworks.

Although the government is working with microfinance institutions and regional governments to improve access to finance for MSEs across the country, still there is lack of access to finance. In this paper, the study examined about the conditions of MSEs on their:

- Initial and current, and future source of finance.
- Need of finance to MSEs and the actual access they received.

- Growth ,expansion, promotion and development
- Loans as a source of finance, the popularity of loans and the most popular providers
- Size and purpose of the loans
- Interest rate of the loans
- Time duration of the loans
- Vision of MSEs to expand and diversify their enterprises in the future
- Conditions of borrowing (collateral and guarantee)
- Challenges of lenders on MSEs
- Time delays of creditors while they lend
- Success of MSEs
- Major hindrance of MSEs
- The role of the government in providing finance for MSEs

Most of the sources of finance for MSEs come from microfinance institutions followed by self financing .On the other hand, a very few generated from their families (father, mother, sister, brother and other close kin's friends and *Ikub*. It is difficult to get finance from formal banks.

The finding of this study exhibit that financial institutions have asked MSEs to pledge collaterals and guarantee. The collaterals include car, land, house and a good having considerable value. Meanwhile, the guarantor should have considerable monthly income and government employee. Furthermore, borrowers should form a group and be guarantor to each other. On top of this, most of the privately owned MSEs were highly asked to bring guarantors and collaterals.

The result of the finding in relation to the demand and the actual access to finance has shown that the majority (69.4%) of MSEs had a demand to finance their MSEs and they had got access to it. However, the remaining percentages were unable to get access to finance to expand, diversify and buy raw materials.

Even out of these which had access to finance, the access was inappropriate. There is insufficient loan size, short-term loans that do not match with the gestation periods and cash flow patterns of borrowers' activities financed by the loan, failure to disburse loans timely, and the tendency of group collateral requirements are the constraints of MSEs' expansion and diversification.

From the findings, it is understood that some of MSE owners are faced high interest rate and hampers them from borrowing because their income and the interest rate they paid is not proportional.

Owner managers have ranked finance, market, raw materials, work place and technology first, second, third, fourth and fifth respectively as their major obstacles impeding the growth, expansion and diversification of their business.

Almost all of MSEs have visions to expand, diversify and promote their business in the future. In opposite fashion, few MSE owners have a vision to continue as it is and others to shut down their enterprise. With the exception of 2%, all of the MSEs are succeeded above and on an average.

5.2. Conclusion

MSEs are engine and bridge of growth. They are the major source of technological innovation and new products; critical for poverty reduction, easily adaptable to remove regional and sector imbalances in the economy, easy entry and exit and make economy more flexible and more competitive. On top of this, they help to diversify the economy and thereby play a significant contribution to export and trade. Moreover, MSEs are important for developing countries such as Ethiopia.

To attain the desired goal of MSEs, access to finance should be there. Although finance is not everything, it is necessary to help MSEs to set up and expand their operations and build up new products. Access to finance provides a range of instrument and information to improve the survival rates, productivity and competiveness of MSEs. Nevertheless, lack of access to finance is one among the other obstacles of MSEs to expand, diversify, promote and growth.

Most of MSEs' finance is relaying on microfinance institutions in addition to their own capital. From the finding, it was possible to identify that no MSE has obtained its capital from formal banks. This implies that the preconditions, including collaterals and guarantors, of borrowing from formal banks are high compared to microfinance institutions.

The preconditions of loans for both microfinance and other formal banks are collateral, guarantee, business plans and other conditions but a little bit less in micro finance. Due to this, it is possible to say that the only alternative access to credit is microfinance institutions. Frankly speaking, only microfinance institutions are not enough to fulfill the gap or need of finance. Accordingly, loan covenant and information requirements and collaterals are causes for the lack of access to finance. In addition to this, inadequate loan size, short loan durations, failure to disburse loans timely, and the tendency of group collateral requirements were hindering some microfinance borrowers.

In the Sub-City, it is observed that there is a gap between the demand of finance and the actual access it. To solve this, microfinance institutions need improvement in their products and service delivery to exploit it. Furthermore, it is also identified that there are many MSE owners who are not the users of credit due to their fear of the high interest rate and failure to pay back the loan principal and interest amount.

Among the many challenges of MSEs, the majority (44.9%) stated that the major hindrance to expand and diversify their enterprises was lack of finance. On the other hand, others stated that lack of work place technology, marketing and raw materials were other obstacles to run the business smoothly.

Although there are challenges to survive in the market for them, almost all of the MSEs have a vision to expand, diversify and promote their business in the future. In opposite fashion, few MSE owners have a vision to continue as it is because they do not have ample money to expand and diversify their enterprises because the money that they have is only for personal consumption.

The government of Ethiopia is working a lot to improve MSEs. Accordingly, the woredas and head office Bureau have been giving training on how to raise funds, bookkeeping, when and where they sale their products, how to produce differentiated products and how to solve conflicts among the group members and other related issues. However, it is not enough. The government has left with many tasks to strength the MSEs.

5.3. Recommendation

After detail investigations on the research title of finance as success or failure factor for MSE, the researcher would like to forward the following constructive recommendations to MSE owners, financial institutions and to the government alike.

The financial institutions should better to revise their design and implementation techniques of borrowing for MSEs in order to present comfortable ground as much as possible. Some of the points advised to the financial institutions and responsible bodies are to:

- ✓ Raise the lending ceiling of micro and small finance loans in order to improve the financial capacity of MSEs.
- ✓ Reduce the bureaucratic procedures while they borrow.
- ✓ Adopt flexible repayment periods.

- ✓ Provide the necessary information where, when and how they borrow to finance their enterprise. Affordable and appropriate finance enable MSE owners to expand, diversify, promote and grow their enterprises efficiently and efficiently.

Only microfinance institutions are not enough to provide credit for MSEs. Therefore, the owners of MSEs should better to find other alternatives such as from Universities, NGOs and other institutions.

To expand MSEs, it is better, if the Sub-City support MSEs by providing adequate training on bookkeeping and follow up the day to day activities. In addition to this, it is important to make the Sub-City fever in providing machinery, cement, work place and other necessary raw materials otherwise; it is hard to compete for most of MSEs with other medium and large scale enterprises.

It would better if the creditors who provide funds to MSEs are at fair interest rate, adequate repayment period and at the right time. By the time, MSEs will grow using this opportunity.

Due to the policies, rules and regulations such as Value Added Tax (VAT), Taxpayers Identity Number (TIN) and other related restrictions, many MSEs are excluded from bidding or entry to contract to certain economic transactions. If there is restriction, the expansion, diversification and growth of MSEs will be limited. So, the Sub-City should better to minimize such restrictions in order to support MSEs

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Appendix

Addis Ababa University

School of Graduate Studies

Departments of Accounting and Finance

Dear Respondents,

The objective of this questionnaire is to secure the necessary and relevant first-hand information that may be useful to conduct a Thesis regarding "***Finance as Success or failure Factor for MSEs in Arada Sub-City"*** which will be used to prepare a Thesis required for my **MSc** degree in Accounting and Finance. Therefore, your response in this regard helps a lot to undertake the study. The result of this survey will be treated with at most confidentiality and will be strictly used for academic purpose only. The researcher thus appreciates in advance your cooperation and sparing your valuable time in filling this questionnaire (responding to the questions).

<u>Questions to be fill by MSE owner managers</u>

Instruction; Please put "✓" mark on the box you need to choose and you can choose more than one answer (if any).

1. What type of business is your enterprise?
   a. Construction materials ☐
   b. Metal work ☐
   c. Wood work ☐
   d. Textile ☐
2. How old is your enterprise?
   a. Below one year ☐
   b. From one year to two years ☐
   c. From two to four years ☐
   d. From four to five years ☐
   e. Above five years ☐
3. How did you start your current business or how the business idea comes?
   a. Self initiation and without group ☐
   b. Advised by families and friends without group ☐
   c. Advised and organized by the Keble ☐
   d. Advised and organized by the head office ☐
   e. Specify, if any---

4. What was your initial source of finance?

a. Myself ☐
b. Families ☐
c. Iqub ☐
d. Friends ☐
e. NGOs ☐
f. Micro financial institutions ☐
g. Formal (large) banks ☐
h. Income from preceding business ☐

Others--

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5. After starting your business, did you feel the need for additional finance

a. Yes ☐ b. No ☐

6. If your answer to question number 5 is yes, to fulfill your need, do you have the access to finance for expansion, diversification, to buy inputs and growth of your enterprise? ☐

a. yes b. No ☐

7. If your answer to question number 6 is yes, what are the sources of finance for your enterprise?

a. Myself ☐
b. Families ☐
c. Iqub ☐
d. Friends ☐
e. NGOs ☐
f. Micro financial institutions ☐
g. Formal (large) banks ☐
h. Income from preceding business ☐

Others--

----

8. For what purpose did your enterprise spend the money received from the above sources?

a. To expand and grow the existed one ☐
b. To diversify (to start other business in addition to the exited one) ☐
c. To start other business by closing the exited one ☐
d. To buy raw materials(input) for the existed one ☐

Other ---

9. For the expansion, diversification, growth and development of your enterprise, what is the degree/significance of finance?
   a. Very high ☐
   b. Fair ☐
   c. Low ☐
   d. Very low ☐
   e. No effect ☐
10. If your answer to question number 7, is from formal or micro financial institutions while you borrowed
   a. Did you asked collateral ☐
   b. Privately without collateral or guarantee ☐
   c. By bringing guarantee ☐
   d. By creating association without guarantee and collateral ☐

   Other ---
11. If your answer to question number 7, is from formal or informal (micro) financial institutions what are the challenges you face from lenders?
   a. They forced us to pay back rapidly before revenue is generating ☐
   b. They charged us high interest rate ☐
   c. There is penalty for late payments ☐
   d. There is time delay ☐
   e. There is no challenge ☐
   f. Other --
12. What was the level of amount of money that your enterprise borrowed?
   a. Excess ☐
   b. Sufficient ☐
   c. Medium ☐
   d. Insufficient ☐
13. If your answer to question number 12 is insufficient, what are the reasons?
   a. Due to lack of collateral ☐
   b. They asked us to form a group ☐
   c. Due to high interest rate ☐
   d. We don't have a need ☐
   e. Other --
14. What is the time duration of payment (repayment) for the money you borrowed?

a. Very long ☐
b. Long ☐
c. Fair ☐
d. Short ☐
e. Very short ☐

15. To question number 14, please specify the time duration in number -----------------
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16. What looks like your capital when you compare from time to time?
    a. Sharply increase ☐
    b. Fairly increase ☐
    c. Stagnant ☐
    d. Fairly decrease ☐
    e. Sharply decrease ☐

17. To question 16 , please strength your answer by specifying in number by writing down the amount of initial and current capital --
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18. What looks like your revenue when you compare from time to time?
    a. Sharply increase ☐
    b. Fairly increase ☐
    c. Stagnant ☐
    d. Fairly decrease ☐
    e. Sharply decrease ☐

19. What looks like the growth in asset (investment) of your enterprise when compare from time to time?
    a. Sharply increase ☐
    b. Fairly increase ☐
    c. Stagnant ☐
    d. Fairly decrease ☐
    e. Sharply decrease ☐

20. Is there any time that your enterprise fails to operate due to finance?
    a. Yes ☐
    b. No ☐

21. If your answer to question number 20 is yes, how did you solve the problems?
    a. By borrowing ☐
    b. By selling asset ☐
    c. By donation from parents ☐
    d. By donation other than parents ☐
    e. Still unsolved ☐

    Other ---

22. What was/is the degree of interest rate on your borrowing?

a. Very high ☐ d. Low ☐
b. High ☐ e. Very low ☐
c. Fair ☐

23. Please write down the interest rate --

24. Did you get the amount of money at the right time without any delay?

a. Yes ☐ b. No ☐

25. If your answer to question number 24 is no, how long the time delayed by creditors

a. Around one week ☐
b. Around two to three weeks ☐
c. Around four to five weeks ☐
d. Around six to seven weeks ☐
e. More than seven weeks ☐

Other --

26. From the financial challenges that may your enterprise faced, which one do you think the most serious problem?

a. Inadequate of loan size ☐ c. Short time duration ☐
b. High interest rate ☐ d. Time delay ☐

If any, please specify ………………………………………………………………………

27. Generally, what is the major challenge of your enterprise during its operation or after it is being in existence?

a. Lack of Finance ☐ c. Market problem ☐
b. lack of technology ☐ d. problem of know-how ☐
e. Lack of raw materials ☐
f. Unable to produce quality products ☐

Other --

28. Do you have a plan to expand and diversify your enterprise in the future?

   a. Yes ☐
   b. We plan to continue as it is ☐
   c. We plan to shout down ☐

   If any specify---
   ---

29. If your answer to question number 28 is yes, what will be the sources of finance?

   a. By owner capital ☐ b. From family ☐
   c. Borrowing form micro financial institutions ☐
   d. Borrowing from large banks ☐
   e. From Iqub ☐ f. From *Idir* ☐

   If any, please specify---

30. If your answer to question number 28 is to shut down or to continue as it is, what is the main cause?

   a. Lack of Finance ☐ c. Market problem ☐
   b. Lack of technology ☐
   d. Because I want to go to other works ☐
   e. Lack of materials ☐ f. Problem of know-how ☐
   g. Disagreement among us ☐
   h. Due to lack of work premise ☐

   Other ---
   ----

31. How to measure the success of your enterprise?

   a. Revenue (sale) ☐ c. Capital ☐
   b. Net profit ☐
   d. Number of employs ☐
   e. Expansion ☐ f. Diversification ☐

   If any --

32. What do you think about the degree of success for your enterprise?

a. Succeeded ☐ b. Limitedly succeeded ☐

c. Failed ☐ d. No change ☐

e. Please specify, if any--

33. What are the formalities that request you to fulfill to obtain loan ?--------------------

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Interview Questions

i. Do you believe that finance is the success or failure factor for MSE operators?

ii. If your answer is yes, how?

iii. If your answer is no, what are the success or failure factors other than finance?

iv. What are the challenges of MSE?

v. What is the contribution of your office to MSEs to expand and diversify?

vi. What are the financial supports that your office provides for MSE operators?

vii. What is the contribution of your office in order to make MSE operators users of borrowing or in order to get access for borrowing?

viii. Does your office provide training for MSE operators on bookkeeping?

ix. Is there any enterprise that is already closed or shut down?

x. If yes what are the reasons?