

Challenges of Financing Micro and Small Business Enterprises (MSEs) in  
Jimma Town

*A Thesis Submitted to the School of Graduate Studies of Jimma University  
Partial Fulfillment of the Award of the Degree of Accounting and Finance (Msc)*

By:

**Terefe Sema Rago**



**JIMMA UNIVERSITY**

**COLLEGE OF BUSINESS & ECONOMICS**

**MSC PROGRAM**

**JULY, 2020**

**JIMMA, ETHIOPIA**

# Challenges of Financing Micro and Small Business Enterprises (MSEs) in Jimma Town

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Under the Guidance of

Matiwos Kebede(PHD)

And

Million Gizawu (Assistant Professor)



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## **CERTIFICATE**

*This is to certify that the thesis entities “Challenges of Financing Micro and Small Business Enterprises (MSEs) in Jimma Town”, Submitted to Jimma University for the award of the Degree of Accounting and Finance (Msc) and is a record of my original research work carried out by Mr. Terefe Sema Rago, under our guidance and supervision*

*Therefore we hereby declare that no part of this thesis has been submitted to any other university or institutions for the award of any degree of diploma.*

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*27/07/2020*

## DECLARATION

I hereby declare that this thesis entitled “*Challenges of Financing Micro and Small Business Enterprises (MSEs) in Jimma Town*”, has been Carried out by me under the guidance and supervision of Matiwos Kebede (PHD) and Million Gizawu (Assistant Professor).

The thesis is original and has not been submitted for the award of degree of diploma any university or instructions.

Researcher's Name

Date

Signature

Terefe Sema

27/07/2020

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**JIMMAUNIVERSITY**  
**COLLEGE OF BUSINESS AND ECONOMICS**  
**MSC PROGRAM**  
**CHALLENGES OF FINANCING MICRO AND SMALL BUSINESS**  
**ENTERPRISES IN JIMMA TOWN**

**BY**

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## ABSTRACT

*The purpose of the study was to determine the challenges of finance for Micro and Small Business Enterprises in Jimma own. The study used descriptive research design. The study included a sample of 378 enterprises from a target population of 7218 MSEs located in Jimma town. Primary data was collected from the study respondents through using self-administer questionnaires. With the quantitative data collected through the questionnaire a descriptive statistical analysis method was used and analyzed descriptively and presented through figures, tables, percentages, bar charts, pie charts and tabulation to show differences in frequencies. Statistical Package for Social Sciences (SPSS) version was used to aid in coding, entry and analysis of quantitative data obtained from the closed ended questions. The study was revealed out the key source of finance for MSEs is personal saving followed by microfinance institutions, which are informal and semiformal source of finance respectively. It was also revealed out the major challenges hindering micro and small enterprises from accessing credit facilities to be stiff collateral requirement, interest rate, and bureaucracy of rules and regulation of credit policy of financial based on the above findings the following recommendations were appropriate it is quite important to seek alternative means of solution to guarantees for collateral requirements such as municipality as a guarantee and resolution of bureaucratic confusion through discussion with concerned bodies and by reduction of interest charge in order to motivate MSEs. the government should incorporating with concerned bodies and give more attention on the issue of human capacity development in order keep and develop efficiency and effectiveness's of the existing and new comer operators on this field. the government should incorporating with concerned bodies and give more attention on the issue of human capacity development in order keep and develop efficiency and effectiveness's of the existing and new comer operators on this field, in addition to this government supports in different dimension to smoothening of operation of MSEs were limited like infrastructure development, provision of incentive, facilitating of complex marketing, and others.*

## **ACKNOWLEDGMENT**

I am indebted to all who encouraged me in the process and give me the courage when I was really in need. It is a pleasant aspect that I have now the opportunity to express my gratitude for them.

First and foremost, I would like to thank God Almighty for giving me the strength, knowledge, ability and opportunity to undertake this research study and to persevere and complete it satisfactorily. Without his blessings, this achievement would not have been possible.

I would like to express my sincere gratitude to my advisor Matiws Kebede (PHD) and co-advisor Million Gizaw(Assistant Professor) for their constructive comments, patience, guidance, and encouragement throughout the process of the research paper.

I am indeed grateful to the staff of Jimma town Micro and Small Enterprise Development Agencies office, for their assistance in giving the necessary data in order to accomplish this research paper fruitfully.

I would like to extend my grateful acknowledgements to my family, my friend and others for their invaluable encouragement; otherwise it could be a great challenge for me to complete my research paper with a great confidence.

And finally, I would like to dedicate this work to my friends Mr. Ayele Dura whose dreams for me have been realized in this achievement and without his loving upbringing and nurturing; I would not have been where I am today and what I am today.

TEREFE SEMA

# TABLE OF CONTENTS

ABSTRACT .....	i
ACKNOWLEDGMENT .....	ii
TABLE OF CONTENTS .....	iii
LIST OF TABLE.....	v
LIST OF FIGURES.....	vi
ACRONYMS .....	vii
<b>CHAPTER ONE.....</b>	<b>1</b>
<b>1. INTRODUCTION.....</b>	<b>1</b>
1.1 BACKGROUND OF THE STUDY .....	1
1.2 STATEMENT OF THE PROBLEM .....	4
1.3 RESEARCH OBJECTIVE .....	6
1.3.1. <i>General Objectives of the Study</i> .....	6
1.3.2. <i>Specific objectives of the study</i> .....	6
1.4 SIGNIFICANCE OF THE STUDY .....	6
1.5 SCOPE OF THE STUDY .....	6
1.6 LIMITATION OF THE STUDY .....	7
1.7 ORGANIZATION OF THE STUDY .....	7
<b>CHAPTER TWO.....</b>	<b>8</b>
<b>2 LITERATURE REVIEW .....</b>	<b>8</b>
2.1 Theoretical literature review .....	8
2.1.1 MICRO AND SMALL ENTERPRISES IN ETHIOPIA CONTEXT .....	9
2.1.2 ROLE OF MSEs FOR ECONOMIC DEVELOPMENT .....	12
2.1.3 OVER VIEW OF FINANCE.....	13
2.1.3.1 <i>Meaning of Finance</i> .....	13
2.1.4 <i>The Need for Finance</i> .....	14
2.1.5 <i>Sources of Finance</i> .....	17
2.1.6 DETERMINANTS OF ACCESS TO FINANCE.....	23
2.1.6.1 <i>Entrepreneur Level Characteristics</i> .....	24
2.1.6.2 <i>Firm Level Characteristics</i> .....	24
2.1.6.3 <i>Institutional Level Characteristics</i> .....	26
2.2 EMPIRICAL LITRATURES.....	26
2.3 OPERATIONAL DEFINITIONS OF THE STUDY .....	33



2.4	CONCEPTUAL FRAMEWORK OF THE STUDY .....	34
	<b>CHAPTER THREE.....</b>	<b>36</b>
	<b>3 RESEARCH METHODOLOGY .....</b>	<b>36</b>
3.1	DESCRIPTION OF THE STUDY AREA.....	36
3.2	RESEARCH DESIGN .....	37
3.3	DATA SOURCES AND GATHERING TOOLS .....	37
3.4	SAMPLING AND SAMPLING TECHNIQUES .....	37
3.5	DATA ANALYSIS .....	39
3.6	VALIDITY OF THE STUDY .....	39
3.7	ETHICAL CONSIDERATIONS.....	40
	<b>CHAPTER FOUR .....</b>	<b>41</b>
	<b>4 DATA PRESENTATION, ANALYSIS AND DISCUSSION OF RESULTS.....</b>	<b>41</b>
4.1	INTRODUCTION .....	41
4.2	SAMPLE RESPONDENT’S RESPONSE RATE.....	41
4.3	DEMOGRAPHIC CHARACTERISTICS OF THE RESPONDENT .....	41
4.4	GENERAL INFORMATION ABOUT THE ENTERPRISES.....	45
4.5	FINANCIAL CHARACTERIZATIONS OF THE RESPONDENTS.....	53
4.6	GOVERNMENT SUPPORT AREA REGARDING MSEs .....	62
4.7	RELATIONAL DATA (CROSS TABULATION) .....	65
	<b>CHAPTER FIVE.....</b>	<b>69</b>
	<b>5 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS.....</b>	<b>69</b>
5.1	SUMMARY OF FINDINGS .....	69
5.2	CONCLUSIONS.....	71
5.3	RECOMMENDATION .....	72
	BIBLIOGRAPHY .....	74
	APPENDIX .....	81

## LIST OF TABLE

Table 2. 1 Summary of MSEs definition in Ethiopian context .....	10
Table 2. 2 Micro and Small Enterprise Sectors and Sub Sectors .....	10
Table 3. 1 Proportionate sample size from each stratum .....	38
Table 4. 1 Response rate of the sample respondents.....	41
Table 4. 2 Demographic characteristics of the respondent .....	42
Table 4. 3 Financial information of MSEs.....	56
Table 4. 4 Challenges of access to finance for MSEs .....	59
Table 4. 5 Government support regarding to MSEs.....	62
Table 4. 6 Cross tabulation of business sector with duration of business .....	65
Table 4. 7 Cross tabulation of business sector with capital range.....	66
Table 4. 8 cross tabulation of legal form of business with working premise.....	68

## **LIST OF FIGURES**

Figure 2. 1 Conceptual frame work of the study	35
Figure 4. 2 line of business in jimma town	45
Figure 4. 3 Numbers of years in business	46
Figure 4. 4 Legal form of business enterprise	47
Figure 4. 5 Motivation to start business	48
Figure 4. 6 Working premise	49
Figure 4. 7 Fixed asset possessions	50
Figure 4. 8 Major problems of MSEs	51
Figure 4. 9 Source of fund for establishment	53
Figure 4. 10 Loan experience of MSEs	54
Figure 4. 11 Challenge to get loan	55
Figure 4. 12 Finance as major factors of business operation	58

## **ACRONYMS**

CSA- Central statistics agency

FDRE MOTI---Federal democratic republic of Ethiopia Ministry of trade & industry

FMSEDA- Federal micro and small enterprise development agency

GDP- Gross domestic product

ICT---Information communication technology

IFC-- International Finance Corporation

ILO-International Labor organizations

MSEs –Micro and small enterprises

MFI- Micro finance institutions

NBE---National Bank of Ethiopia

NGO- Non-governmental organizations

OCSSCO---Oromia Credit and Saving Share Company

SPSS – Statistical packages for social science

TVET- technical and vocational educational training

# **CHAPTER ONE**

## **1. INTRODUCTION**

### **1.1 BACKGROUND OF THE STUDY**

Micro, Small and Medium Enterprises are known for contribution in industrial output, employment, export, attracting new talent which helps in generating and implementing ideas properly. In developing countries micro, small and medium enterprises are important as it contributes to GDP and employment (Dalberg 2011). It distributes the national income in more effective and efficient manner. From micro, small and medium enterprises large businesses are quite benefitted. MSME sector promotes countries resilience through diversifying and broadening domestic economy (UNDP, 2013). Because of MSME sector, labour force are less dependent on large enterprises (Dalberg, 2011). Despite the various problems and challenges faced by MSMEs like inadequate market linkages, infrastructural problems, inadequate flow of institutional credit it has tremendous potential to grow.

Government and a country, in regard to business development, success is related to small business sustainability (Carrasco-Davila, 2005) government authorities had been developing programs that promote the creation of job opportunities through the small business (Plan Nacional de Desarrollo, 2007). This sectors are recognized as an integral element of economic development and a crucial component in the effort to lift countries out of poverty. Small businesses play a significant role in the development of a country and serve as tools to sustain and grow economies (Ibrahim, Angelidis, & Parsa, 2008). Because of ease and simplicity in operation, small businesses are initiated for various reasons depending upon entrepreneur motives and traits (Kozan 2006). The development of Policies to promote MSEs is common in both developed and developing countries (Storey, 2008 & Hallberg, 2010). In case of developed countries, during the last two or three decades it has become common place for governments to implement and exercise policies or programs designed to promote aspects of micro and small-sized enterprises (MSEs). This has coincided with an increase in the significance, in terms of contribution to employment and GDP growth, of SMEs in most of the developed economies (Storey, 2008). In the case of developing economies, policies designed to assist MSEs have been an important aspect of industrial policy and multilateral aid programs such as those of the United Nations since the 1950s (Levitsky,2000). However, while there are

wide variations across countries the traditional picture is one where the relative importance of SMEs tends to decline as a country moves up the developmental ladder (Hallberg, 2000; and Liedholm and Meade, 2010).

In addition, MSEs comprised of a significant proportion of the business enterprises both in developed and in developing countries (OECD, 2006; FaL Oki, 2012). It is therefore, argued that; from the perspective of their significance on economies, MSEs warrant attention from governments. Storey (2008) has argued, in the UK context, that the increased importance of MSEs means that public policies towards them cannot be considered in isolation from other influences in the economy and cannot be left to those with a particular interest in MSEs.

*“According to Hallberg, Despite a long history of development efforts, MSEs were perceived rather as a synthetic construction mainly of “social and political” importance (Hallberg, 2000), especially throughout the 1980’s and up to late 1990’s. Although domestic MSEs constituted most of what could be and what are still deemed as the private business activity in most developing countries, private sector development strategies advocated for and implemented in these countries were skewed towards the needs of large scale business, Including foreign investment. This type of policy advocate was partly motivated by the rather disappointing (Meyer-Stamer, Jörg and Frank Waltering, 2000) results achieved through extensive MSE support systems operated in developed countries since the 1970’s.”*

While the contributions of MSEs were recognize, many countries developed programs and policies were developed to support them, their journey in many instances is short-lived with high rate of failure mostly in Africa due to several factors (Michael and Jeffrey, 2009; Lussier, 1996; Honjo,2000; ILO,2007; Wiboonchutikula, 2001; Zewde and Associates, 2002).There are many obstacles hindering their growth such as capacity to penetrate in to the new market and stable with in the market, lack of access to credit, insecurity, debt collection, marketing problems, shortage of working space, lack of standardized product in the market, change in demand and absence of market linkages, lack of raw material accessibilities (Wiboonchutikula,2001).

Okpara & Wynn (2007) conducted research on small business development has shown that the rate of failure of MSEs in developing countries is higher than the developed world.

On the study of Geberhiwot and Wolday, (2006) more than 11,000 MSEs in Ethiopia were surveyed and about 5 percent of them admitted having main constraints like shortage of working space for production and marketing, shortage of credit and finance, regulatory problems (licensing, organizing, illegal business), poor production techniques, input access constraints, inadequate management and business skill, absence of appropriate strategy, lack of skilled human resource, low level of awareness of MSEs' as job area, low level of provision and interest for trainings and workshop. These constraints confirm with other developing countries, especially poor management, corruption, lack of training and experience, poor infrastructural development, insufficient profits and low demand for product.

Like in other developing countries Ethiopia has been using MSEs increasingly used as a strategy for fostering socio-economic development of the country. MSEs have been contributing to national economy in- terms of employment opportunity, export promotion, stimulating the development of innovation, and indigenous skills for sound entrepreneurship, decentralization of industries, industrial linkages, and utilization of resources and transfer of technology. More generally, the development of MSEs has seen a vehicle for accelerating the achievement of wider socio-economic objectives and poverty reduction in developing countries like Ethiopia.. This could be due to the unique features of the MSE sector: like labor intensiveness; suitability to produce more jobs with less capital per job created; utilizes local and cost wise resources; uses simple and affordable technologies; fosters linkage formation within and among various sectors and its resilience to internal and external Economic shocks (NBE,2017/18).

In recognition of the sector's significant contributions and its constraints or challenges, the government has been trying to create enabling environment for its growth and promotions. Among others, issuance of proclamation No 33/1998 to establish the federal micro and small enterprise development agency (FMSEDA), issuance of MSE development strategy in 2017, and revision of the proclamation by No 104/2017 are the major government efforts made to alleviate the constraints of the sector of micro and small enterprise. In response to the government's efforts, MSE support institutions are increasing both at federal and regional levels. (FMSEDA, 2017)

Despite the developments of the support institutions, the MSE sector is still confronted with

several drawbacks and challenges they have to overcome in order to maintain and operate successfully. Major obstacles include access to finance, capacity to penetrate in to the market and stable with in the market, infrastructure market access, appropriate technology and access to raw materials. However, peculiar and most critical problems to MSEs are lack of access to financial sources both as initial and as working capital (FMSEDA, 2017).

This, to addressing the most challenging factor, i.e., Sources and challenges of finances has been seen as tackling the other factors. To deal with this issue one should understand how these enterprises raise finance and what challenge they face at the outset or establishment and in their operation. Hence, this research was conducted to assess the MSEs in Jimma town with a specific focus on the sources and challenges of finance.

## **1.2 STATEMENT OF THE PROBLEM**

Now-a-days; Small-scale enterprises have become an important contributor to Ethiopia's economy. The sector contributes to the national objective of creating employment opportunities, training entrepreneurs, generating income and providing a source of livelihood for the majority of low income households in the country, accounting for material amount of GDP (Eshetu and Mammo, 2009). Given the contribution of SMEs to the Ethiopian economy, there is need to conduct an empirical study to examine not only the challenges they face in accessing finance but also the approaches that can be adopted to manage these challenges with reference to SMEs firm operating in Jimma Town. However, the previous study are not fit, had this sector been provided proper emphasis, it may have high potential to meet the objective they were envisaged for. Yet the majority of entrepreneurs in this sector are considered un credit worthy by most formal credit institutions as per the report of World Bank's (2009) and by Abebe, Million and Andrew (2009) about businesses and their access to finance in Ethiopia. While there are a number of factors hindering the development and emergency of small firms the basic and the one challenge that seeks attention is access to finance (Ayyagors, Demirguc-Kunt and Maksimovic, 2006). Improving the availability of finance facilities to this sector is one of the incentives that have been proposed for stimulate its growth and realization of its potential contribution to the economy in the form of employment opportunity, income to the owner, taxes to the government, but the need of small scale business especially access to finance became complicated when they grow and involve in innovative activities. Despite this emphasis, the effects of existing institutional problems, though finance is not everything , enterprises need finance to invest in new equipment ,machinery,and reach out to new markets and products and scope with temporary cash flow shortage as well as to innovate and expand (Derese,Zerihun 2017



p.101).In view of the above Derese,Zerihun 2017 wrote the Ethiopian government is doing all its best to support MSE'S. Despite its efforts many research out puts conducted in Ethiopia indicated that the access to finance is still the bottleneck for the enterprises. For instance a recent survey by federal MSE development of revised agency (2016) indicated shortage of finance that account for (42 percent) was principal challenge followed by lack of working premises (28.3 percent) and lack of access to market (18.10 percent) for the MSE'S in regional cities.

Recently, however, there is a proactive movement towards understanding the potential of the sector in helping reduce poverty among stakeholders (academicians, development practitioners, NGOs, donors, and politicians).

The study sought to establish the challenges facing MSEs in accessing credit facilities in Jimma Town. The specific objectives were; to establish the influence of collateral requirements on accessibility of credit facilities by MSEs in Jimma Town, to determine the influence of cost of credit on accessibility of credit facilities by MSEs in Jimma Town, to investigate the influence of availability of information on accessibility of credit facilities by MSEs in Jimma Town, and to establish the influence of business risks on accessibility of credit facilities by MSEs in JimmaTown. This study will help to fill the void in the knowledge gap. Therefore, this study seeks to answer the following questions;

- What are the sources of finances for MSEs?
- What are the challenges MSEs finance from various source?
- Did MSEs have received different types of support expected from various stockholders?
- What actions are required to overcome the problem of MSEs?

## **1.3 RESEARCH OBJECTIVE**

### **1.3.1. General Objectives of the Study**

The overall objectives of the study is to assess the challenges of financing for MSE in Jimma town.

### **1.3.2. Specific objectives of the study**

- ❖ To identify which type of financial sources are mostly used by MSE.
- ❖ To assess the challenges faced by MSEs finance from various source.
- ❖ To assess the support provided by the stockholders to MSEs.
- ❖ To assess the solution or action needed to overcome the challenges that faced by MSEs.

## **1.4 SIGNIFICANCE OF THE STUDY**

MSEs Plays a great role in an economy but little is known about how the sectors' financial sources are going on and what challenges they face. Problems' MSEs was address through appropriate measures for their huge potential as area of employment; home of natural entrepreneurship; benefits of the flexibility and exploitation of sectorial linkage can be maximized. Therefore, the findings which were obtained as a result of conducting the research have certain areas of significance:- firstly to give an understanding of source and challenges MSEs in line with finance, secondly to reduce blurred current conditions of MSEs in aspects of source and challenges of finance. Third significance were served as spring board to other researchers for further investigation, fourthly to give supportive recommendations that would facilitate the growth of MSEs, the last but the list In general, this study was used to gives some insight about source and challenges of finance for MSE and may serve as stepping-stone for other studies.

## **1.5 SCOPE OF THE STUDY**

Covering of huge study area at many dimensions and direction and different sectors of business are very encourage able activities of the researcher, However, due to time and resource constraints

the study focus is only one sector i.e., MSEs. Even though the concepts of MSEs consists a number of dimensions like marketing, success factors, etc., the scope of this study was delimited to the source and challenges of finance for MSEs. The other dimensions were beyond the scope of the study. Geographically, the study focus is in Jimma Town.

## **1.6 LIMITATION OF THE STUDY**

Basically, research is a big task it requires, finance, research knowledge, and different material supports so as to arrive at credible conclusions Most of the document that are concerned with micro enterprises are written in Afan Oromo; to translate in to the required instruction language (English) takes longer period. It is very important to note these limitations did not have any significant impediment with the outcome of the study. Absence of timely returned distributed questionnaire by sample of respondents and they needed reminding to complete and return in order to proceed to the next action at the right time and it make the researcher exhaustively busy for the completion.

## **1.7 ORGANIZATION OF THE STUDY**

The study was organized in five chapters. The first chapter is the introductory part of the study, which contains background of the study, statement of the problem, objectives of the study, significance of the study, scope of the study, and organization of the study. The second chapters are devoted to the presentation of literature reviews of related researchers. The third chapter deals with research methodology of the study which presents description of the study, research design, data sources and gathering tools, sampling and sampling technique, data analysis and presentation, validity of research and ethical consideration. The fourth chapter was the analysis and discussion of data collected. The final chapter summarizes, concludes the results obtain from the findings and suggests the necessary recommendations for the study.

# CHAPTER TWO

## 2 LITERATURE REVIEW

### 2.1 Theoretical literature review

The definition of micro and small enterprises is still controversial and debating. There is no generally accepted definition of micro and small enterprises. Micro and small enterprises are different one country to other because one country small enterprise may be medium enterprises in the other country. Many developing countries apply based on specific parameters, which include factors such as the number of employees, capital, asset, etc. The definition which is based on the above criterion partially focuses on specific target groups for any preferential treatment of the various actors in the MSE recognizing that, there are no standard definitions of MSE. Thus, the definition of MSE depends on the stage of economic development of the country.

According Bolton Committee (2010), first a—economicl and —statisticall definition of a small firm was formulated. Under the —economicl definition, a firm is said to be small if it meets the following three criteria: relatively small share of their market place, managed by owners or part owners in a personalized way, and not through the medium of a formalized management structure; and independent, in the sense of not forming part of a large enterprise. On the other hand, the —statisticall definition, the Committee proposed two criteria; size of the small firm sector and its contribution to GDP, employment, exports, etc.; the extent to which the small firm sector’s economic contribution has changed over time (Bolton, Richard A,2010)

The sectorial classification has also used as criteria to define MSEs by Bolton Committee. Accordingly, firms in manufacturing, construction and mining were defined in terms of number of employees (in which case, 200 or less qualified the firm to be a small firm), those in the retail, services, wholesale, etc. were defined in terms of monetary turnover (in which case the range is 50,000-200,000 British Pounds to be classified as small firm) whereas, firms in the road transport industry are classified as small if they have 5 or fewer vehicles (Bolton,Richard A,2010).

European Union (EU) Member States, traditionally have their own definition of what constitutes an SME, for example the traditional definition in Germany had a limit of 250 employees while in Belgium it could have been 100. But now the EU has started to standardize the concept. Its current

definition categorizes companies with fewer than 10 employees as "micro", those with fewer than 50 employees as "small", and those with fewer than 250 as "medium" (Carsamer, 2010).

By contrast, in the United States, when small business is defined by the number of employees, it often refers to those with fewer than 100 employees, while medium-sized business often refers to those with fewer than 500 employees. Canada also defines a small business as one that has fewer than 100 employees (if the business is a goods-producing business) or fewer than 50 employees (if the business is a service-based business), and a medium-sized business as fewer than 500 (Carsamer, 2010).

Generally, from the global experiences of the definitions of MSE entails that there is no commonly used definition of MSE across the countries of the world. However, all the definitions have taken the common criteria such as the number of employees, paid up capital, sectorial category, market share and the management entity.

### **2.1.1 MICRO AND SMALL ENTERPRISES IN ETHIOPIA CONTEXT**

Similar to the global experience, the definition of MSEs in Ethiopia consist paid up capital and number of employees as criteria except that it categorize the firms as formal and informal. In Ethiopian, the MSE development strategy defines MSEs according to the number of employees and capital (FMSEDA, 2010). Micro Enterprise under the industry sector (manufacturing, construction and mining) is an enterprise operates with 5 people including the owner and/or their total asset is not exceeding Birr 100,000. Under service sector (retailer, transport, hotel and Tourism, Information Communication Technology (ICT) and maintenance service) Micro enterprise are an enterprise operate in with 5 persons including the owner of the enterprise and/or the values of total asset is not exceeding Birr 50,000. Small Enterprises in the industrial sectors are an enterprise operating with 6-30 persons and/or with a paid up capital of total asset Birr 100,000 and not exceeding Birr 1.5 million. Similarly, in the service sector, small enterprises are an enterprise operating with 6-30 persons and/or with a paid up capital of total asset Birr 50,000 and not exceeding Birr 500,000 (FMSEDA, 2012).

## Summary of MSEs definition in Ethiopian context

Table 2. 1 Summary of MSEs definition in Ethiopian context

Enterprise	Sector	No of Employee	Total asset ETB	Total asset USD
<b>Micro-enterprise</b>	Industry	≤5	≤ETB 100,000	≤ 4,630
	Service	≤5	≤ETB 50,000	≤ 2,310
<b>Small-enterprise</b>	Industry	6-30	101,000-1,500,0000	4,630 -69,500
	Service	6-30	50,0001-500,000	2,310 - 23,150

Source MOUDH 2016

## Micro and Small Enterprise Sectors and Sub Sectors

Table 2. 2 Micro and Small Enterprise Sectors and Sub Sectors

<b>Manufacturing Sector</b>	<b>Trading</b>	Urban agriculture
Textile and garment	Wholesale of local products	Modern animal husbandry
Leather and leather products	Retail trade of local products	Poultry
Food processing and beverage	Raw material supply	Modern afro-forestry
Metal works and engineering	<b>Service sector</b>	Fruits and vegetables production
Wood works including furniture	Rural and small scale transport services	Decoration services (interior?)
Traditional handicrafts and jewelries	Cafeteria and restaurant	Beekeeping
Agro processing	Warehousing services	Modern irrigation
Construction materials production	Tourist services	Animal feed processing
<b>Construction Sector</b>	Packaging services	Product design and development services
Contracting	Management services	Security and cleaning services
Sub-contracting	Municipal services	Maintenance services
Cobble stone works	Project engineering services	Beauty saloons
Sub-contracting for infrastructure construction	Landscaping, urban greenery,	

<b>Agriculture Sector</b>	Electronics and software development	
Local mining works	Internet café	
Precious stones	Garage and assembly works	

Source MOUDH 2016

Similar to the global experience, the definition of MSEs in Ethiopia consist paid up capital and number of employees as criteria except that it categorize the firms as formal and informal. According to Ministry of Trade and Industry (MoTI) definition, MSEs based on capital investments a yardstick, has been developed for formulating micro and small enterprise development strategy in 2006. The definition given by MoTI states the difference between micro and small enterprises based on paid up capital. Micro enterprises are those businesses enterprises, in the formal and informal sector, with a paid up capital not exceeding Birr 20,000 and excluding high-tech consultancy firms and other high tech establishments whereas, small enterprises are those business enterprises with a paid up capital of above Birr 20,000 and not exceeding Birr 500,000 and excluding high tech consultancy firms and other high tech establishments (Commission on Legal Empowerment of the Poor, 2006).

On the other hand, Central Statistical Agency (CSA) categorizes enterprises into different scales of operation on the size of employment and the nature of equipment. According to CSA; Establishments employing less than ten persons and using motor operated equipment are considered as small scale manufacturing enterprises whereas enterprises in the micro enterprise category are subdivided into informal sector operations and cottage industries. As the third category, Cottage and handicraft industries are those establishments performing their activities by hand and using non power driven machines.

In light of the above definitions and taking into consideration the Ethiopian situation, micro, small and medium enterprises (MSMEs) may be defined in the following way:

- Micro enterprises are business activities that are independently owned and operated, have small share of the market, are managed by the owner and employing five or less employees. This has recently been revised to include employment until 10 workers and capital reaching up to 20,000 birr.
- Small businesses are those enterprises that employ 6 to 49 employees. They share the same characteristics with micro enterprises in other aspects.

- Medium scale enterprises are those enterprises which have a relatively higher share of the market, are independently or jointly owned or managed by the owner or by appointed executives and employ 50 to 99 persons.
- Those enterprises that employ more than 100 persons could be considered as large enterprises (Commission on Legal Empowerment of the Poor, 2006).

The definition given above by Ministry of Trade and Industry for MSE in the context of Ethiopia is similarly applied in the Oromia Regional State in jimma town.

### **2.1.2 ROLE OF MSEs FOR ECONOMIC DEVELOPMENT**

Two schools of thought have emerged as pro-MSE's and anti-MSE's perspectives in the studies of MSE's regarding their role in developing and developed countries. Most donor countries and development agencies share the view of the pro-MSE's that is springing up of such entrepreneurial and innovative ventures help promote economic growth and help reduce the high poverty level in such developing economies (Beck & Demirguc-Kunt, 2004).

The pro-MSEs has argued that MSE's enhance competition and entrepreneurship and thus have economy wide benefits in efficiency, innovation and productivity growth. Thus, direct government support of MSE's can help countries reap social benefits. Second, MSE's are generally more productive than large firms but are impeded in their development by failures of financial markets and other institutions for capital and other non-financial assistances.

Thus, pending financial and institutional improvements, direct government support of MSE's can boost economic growth and development. The growth of MSE's boosts employment more than the growth of large firms because MSE's are more labor intensive So subsidizing MSE's may help reduce poverty (Beck & Demirguc-Kunt, 2004). However, the anti-MSE has questioned the efficacy of MSE's in promoting growth and reducing poverty. First, they argue that large enterprises may exploit economies of scale and more easily undertake the fixed costs associated with research and development, boosting productivity. They argue further that some researchers found that small businesses are neither more labor intensive nor better at creating jobs than large firms (Thormi & Yankson, 1985). Moreover, they doubt the crucial role of small businesses and instead emphasize the importance of the business environment facing all firms, big and small. Small businesses create monopoly. They are of the view that if there are low entries and exit



barriers, well defined property rights, effective contract enforcement, and access to finance, it will work to promote conducive business environment for all firms and not only small firms (Demirguc-Kunt, 2004).

However, scholars attempted to reconcile the above controversies by the flexibility of the business technology and people involves. Levy & Powell (2005) noted that, MSE's are thought to be flexible and innovative organizations that are able to respond quickly to customer and market demands (flexibility). Contrary to what happens in large firms, the production technologies of many manufacturing MSE's may inhibit flexibility (Gupta & Cawthorn, 1996), while Carrie et al. (1994) believe that it is people rather than technology that provides flexibility.

Despite the controversies in efficiency and poverty reduction, literature shows small business plays a vital role in the socio economic and political contribution in both developed and developing nations. Small business contributes to equitable distribution of wealth and decentralization of economic power. A small business requires less capital and they are labor intensive in their nature.

## **2.1.3 OVER VIEW OF FINANCE**

### **2.1.3.1 Meaning of Finance**

Business concern needs finance to meet their requirements in the economic world. Any kind of business activity depends on the finance. Hence, it is called as lifeblood of business organization. Whether the business concerns are big or small, they need finance to fulfill their business activities. In the modern world, all the activities are concerned with the economic activities and very particular to earning profit through any venture or activities. The entire business activities are directly related with making profit. Finance may be defined as the art and science of managing money. It includes financial service and financial instruments. Finance also is referred as the provision of money at the time when it is needed. Finance function is the procurement of funds and their effective utilization in business concerns .On the other hand according to the Wheeler,Business finance is that business activity which concerns with the acquisition and conversation of capital funds in meeting financial needs and overall objectives of a business enterprise(CSA,2003).

According to the Guthumann and Dougall, —Business finance can broadly be defined as the activity concerned with planning, raising, controlling, administering of the funds used in the business( ILO, 2008).

According to the Encyclopedia of Social Sciences, —Corporation finance deals with the financial problems of corporate enterprises. These problems include the financial aspects of the promotion of new enterprises and their administration during early development, the accounting problems connected with the distinction between capital and income, the administrative questions created by growth and expansion, and finally, the financial adjustments required for the bolstering up or rehabilitation of a corporation which has come into financial difficulties.(Cited from: file:///H:/definitions -of- finance)

#### **2.1.4 The Need for Finance**

It has long been recognized that in developing countries, micro and small enterprises (MSEs) have a dynamic role and serve as engines through which the growth objectives of developing countries can be achieved. MSEs by virtue of their size, capital investment and their capacity to generate greater employment have demonstrated their powerful propellant effect for rapid economic growth in developing countries (ILO, 2008; Lara and Simeon, 2009).

Although, MSEs are major contributors to the gross domestic product (GDP) and employment in economies around the world, their financial needs are underserved, which holds back their growth. Where financing is available, it is usually out of reach because of short payback periods and excessive collateral requirements. Nonbank financing options, such as leasing, are not always available. In many developing economies, certain segments of the population, primarily women, are excluded from business activity, because traditionally they do not own land, which is often the preferred collateral for loans (Sahar, 2010).

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 (World Bank, 2008).Availability of finance determines the capacity of an enterprise in a number of ways, especially in choice of technology, access to markets, access to essential resources which in turn greatly influence the viability and success of a business. Securing capital for business start-up or business operation is one of the

major obstacles of every entrepreneur, particularly those in the MSE sector (Solomon, 2009).

In the current environment characterized by a reduced availability of credit and tighter Lending standards, the financing needs of MSEs deserve particular attention. In this regard it is important to recall that MSEs in general are more dependent on their personal savings and relatives than larger firms, which have the expertise, experience, and resources to tap the financial markets obviously; a decision to start a business or expand an already existing firm involves an implicit decision of how to raise money. Consequently, financing is at the center of an operation of MSE. For instance, it is indicated that the inability to raise finance is one of the greatest challenges facing the MSEs and is the critical factor in the establishment and growth of such businesses (Sargent and Young , 2004).

Similarly, it is pointed out that MSEs 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 (Fafchamps cited in Gebrehiwot and Wolday, 2006). Some argue 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 [without basically changing the dual nature of the economy] rather than being used to convert a very small number of businesses into modern capital- intensive ones (Ibid, 2004:54). In spite of this, MSEs limited access to available finance compared to larger organizations have limited their growth and development. In addition, MSEs are forced to higher transaction costs than larger enterprises to obtain finance. Moreover, insufficient funding has been made available working capital scarce (Levy, 2000).

According to the 1995/96 survey of urban informal activities in Ethiopia, lack of working Capital was among the most pressing problems that small manufacturing industries identified (the others being marketing and shortage of supply of raw materials) as limiting expansion of their business. According to the survey of 1995/96, 50% of the informal sector operations indicated that their main problem in operation was lack of sufficient initial capital. Lack of sufficient capital, particularly at the start of their operations, was also identified as the major problem for about 35% of the small scale manufacturing industries (Gebrehiwot and Wolday, 2006).

Some researchers, however, argued that factors such as marketing or technological assistance

might be the critical factors in the success or failures of MSEs. Yet, despite the contribution of these factors to the development of such enterprises, it should not be overlooked that marketing or technological assistance do require finance. Marketing normally involves producing quality product, promotion and making the product available at the consumers' destination. Undoubtedly, such activity requires considerable amount of finance which MSEs have limited access to it. Technological assistance, too, no matter how it is made available, is not cost free to run. It requires knowledge to operate and maintain, thereby requiring finance. Some also argued that capital, being scarce in developing countries should essentially be deployed in a way that maximizes the creation of jobs and production of new goods and services rather than being used to convert a very small number of businesses into modern capital intensive only (Wolday, 2006).

It is generally assumed by policymakers in developing countries that there is either a high unsatisfied demand or a significant potential demand for finance by MSEs' borrowers. It is also assumed that where this does not already exist, it can be created. These assumptions lead to policies that have been described as either 'demand-following finance' or 'supply-leading finance'.

In many developing countries where the MSEs sector is seen to be active, (at least in terms of numbers in relation to the size of the economy) and where one of the biggest constraints to its further development is perceived to be finance, general governmental policy on the development of the financial system may be regarded to be 'demand-following'. What is interesting about this type of 'finance is that as a result of market imperfections, the financial system's development does not always automatically follow the growth of the real sector of the economy. In fact, the increased supply of financial services in response to demand may not be at all automatic, flexible or inexpensive in developing countries. Restrictive banking legislation, religious barriers against interest charges and imperfections in the operation of the market mechanism may dictate an inadequate demand following response by the financial system (Helmsing and Kolstee, 1993).

In view of these impediments to the 'demand-following' effect, a need is often perceived for intervention in the intermediation process, specifically for the redirection of credit. Intervention entails governments setting up institutions where the private sector is deemed incapable of doing

so, pegging deposit and lending rates at levels perceived to be fair to borrowers and savers but not necessarily coinciding with free market levels, rationing credit to different rates under criteria that underlie mainly government priorities (Ibid, 1993).

Financing of MSEs is one of the best ways to provide regular employment to millions of poor people. MSEs are, nowadays, taken as a development vehicle for least developed countries like Ethiopia as clearly stated in the industrial development strategy of the country. Their proliferation apart from creating employment opportunity would help to facilitate capitalist industrialization. A path to development, nonetheless, could not be realized without enabling economic environment and access to finance. Financial sources, in this case, are the most important factor determining the survival and growth of MSEs at the time of establishment and operation in both developing and developed countries. Here in order to be effective the need for finance must be ‘demand-following’ rather than ‘supply-driven’. Finance must not be offered by the force of finance providers rather the MSEs must have the initiative to get the money they require. However, this does not mean that the financial system (financial institutions) must be passive.

### **2.1.5 Sources of Finance**

Theoretically, enterprises may use internal and external sources of finance. The former comprises own savings and retained earnings while the latter includes security finance, explicit borrowing from formal and informal sources, implicit borrowing in the form of Accounts payable (i.e. trade credit and advances from clients), hire purchases, and lease to-buy contracts. For firms that can’t resort to primary and secondary money and capital markets (either because the markets do not exist or the firms are not in a position to access such markets) (Gebrehiwot and Wolday, 2006). For instance, raising funds through securities (bond and equity) issue involves listing requirements that are too stringent for many firms to meet, and is costly.

This leaves explicit (formal or informal) and implicit borrowing. But 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, and lack of education.¶ Yet, they are generally able to obtain ‘venture capital’ relatively cheaply partly as a consequence of the absence

of a stock market that minimizes the adverse selection and moral hazard problems. Unable to invest their savings in high- return/high- risk investments via an organized market, the only possible forms of such investment for small investors are either—creating one’s own enterprise, or financing the enterprises of close friends and relatives whose skills and performance can be monitored (Fafchamps, 1994).

According to Chant and Walker (1988), on the other hand, the two crucial sources of funding for working capital of MSEs for example, trade and bank credits are critical sources of funding for working capital. Bank credit typically finances ongoing operations, seasonal or cyclical cash flow shortages, start-up costs for new operations, etc. Trade credit; on the other hand, is given for the purchase of raw materials and other inputs.

In Ethiopia, the potential sources of finance include conventional banks, MFIs, cooperatives, government projects, and other informal lenders, as well as trade credit. Equity finance is limited: although we have not direct evidence, one could reasonably expect much more equity finance to be forthcoming in a situation where equity holders (in partnerships, for example) could liquidate their holdings quickly and with relative ease when they want to (Gebrehiwot and Wolday, 2006). Generally finance sources can be discussed categorically in many classifications. Some may classify them as institutional and non-institutional others in degree of formality of operating within a given financial system which can be classified as formal, semi-formal and informal sources of finance.

#### **2.1.5.1 Formal Source**

Formal sources are providers of finance who are subject to banking laws of the country of operation and are engaged in loan extension to customers and diversified financial intermediation (Tewodros, 2005). Formal credit institutions generally shy away from lending to MSEs. A recent study indicated that in most countries, MSE finance accounted for less than 1 percent of the broad money supply, with the major exceptions being Indonesia and Thailand (about 6 percent each) and Bangladesh (3 percent). It is difficult for micro-enterprises to obtain credit because of their lack of fixed assets, their low volumes of business and their existence on the margins of, or outside, the law (Leleux and Constantinou, 2007).

In the Ethiopian context, the formal finance sources are Commercial Banks (private or public owned), Development Bank of Ethiopia. Commercial banks aim to provide service such as deposits mobilization, working capital, and loan extension for enterprises operating in any economic sector, and feasible projects financing. The provision of the financial service may be for short, medium and long time horizon. Invariably commercial banks assesses the credit worthiness of the applicant using the traditional five parameters, namely, capacity; collateral; capital; condition; and character.

Regardless of the number, nature, and type of loan extension criteria conventional banks are not interested in providing finance to MSEs for they are not only faced with lack of having adequate information, infrastructure but also are not required to finance MSEs in their mission statements. Nor is their capacity, especially their branch network, extensive and dense enough to effectively reach MSEs throughout the country (in rural areas in particular). Moreover, the delivery of financial services to MSEs requires the development of innovative financial products that attract MSE operators, which Ethiopian banks are lacking. Besides, conventional banks in Ethiopia do not have interest in promoting new markets with higher perceived risks (MSEs) and relatively high information costs. As a result, the formal banks deliberately avoid the delivery of financial services to MSE operators who might need small loans such as Br. 10,000, 15,000, 20,000, 30,000 etc.(CSA, 2008).

#### **2.1.5.2 Semi-formal sources**

Semi-formal sources are those providers of finance that are mostly registered as NGOs and MFIs with special charter. NGOs are no longer involved, at least officially, since the issuance of micro-finance law, Proclamation Number 40/1996, which requires those involved in the provision of micro-finance to be established as share companies (owned only by Ethiopian nationals), prohibiting them from them directly involving themselves in credit and savings activities. The new approach to microfinance has taken root in Ethiopia as could be seen from contents of the proclamation enacted to govern micro finance activities in Ethiopia (Proclamation Number40/1996). MFIs are mushrooming following the proclamation: in the last years, the micro-finance industry showed remarkable growth in terms of outreach and performance (Gebrehiwot and Wolday, 2006). MFIs helps people start their own businesses i.e., MSEs, by providing loans

which will be difficult to get from the main banking system of Ethiopia. MFIs originally were established in the form of rural finance providers. And they have been expanding in Bolivia, Bangladesh and Indonesia. At that point in time, they were united under the banner of micro finance'. Proving cheaper edit was at the center piece of many of the MFIs. Moreover, such MFIs had shared the commitment to serve MSEs that have been excluded from the formal banking sector (Martin, 2001). As a result, MFIs were, being a subsidized credit support program, expected to deliver finance for needy groups and firms. MFIs used to follow up the poverty approach in the pursuit of credit extension. This approach is criticized for developing the non-loan repayment culture.

Despite the increase in number of the institutions, MFIs in Ethiopia have little impact in developing the country. For they are agricultural oriented and peasantry focused with limited outreach to MSEs and the absence of varieties in the type of financial products delivered regardless of MSEs area of operation (Wolday, 2002). The new financial systems approach emphasizes large-scale outreach to the economically active but poor, both to borrowers who can repay micro loans from household and enterprise income streams, and to savers. This approach focuses on institutional self-sufficiency, because, given the scale of the demand for micro-finance, this is the only possible means to meet widespread clients 'demand for convenient and appropriate financial services (Gebrehiwot and Wolday, 2006).

Besides, the groups guarantee schemes; small sized loan coupled with short repayment period has made MFI's service unattractive to urban MSE operators. Moreover, the supply driven lending methodology instead of demand driven methodology has further exacerbated the unattractiveness of their services (Tewodros, 2005). Furthermore, it is argued that MFIs despite monopolizing (because by default MSEs is Out of reach to formal sources of finance) the financial service provision functions have become non self-reliant and inefficient. They have failed to understand what MSEs need most. While the need of MSEs is access to credit, MFIs stick to the paradigm of cheap credit. Yet, MFIs were supposed to fill in perceived gabs in financial intermediation particularly, the provisions of long-term finance. Their impact, however, appears to be the increase in financial sector segmentation (Martin, 2001).

In order to overcome such critics, MFIs should be move concrete by letting down the poverty



alleviation approach and adopting the financial system perspectives approach that emphasizes their institutional sustainability. In the context of Ethiopia, the objective of almost all MFIs is poverty reduction, mobilizing savings, and extending credit to MSEs. The maximum amount of group loan does not exceed Br. 5,000 and the repayment period does not exceed one year. Though the group methodology waived the need for collateral, it is surrounded by the old paradigm and could not fit individual loan requirement (Tewodros, 2005).

### **2.1.5.3 Informal sources**

Unlike the formal and semi-formal sources, the informal sources do not constitute a neat category.. Informal sources provide finance to most of MSEs operating outside the formal financial system. Informal sources are important source of initial as well as working capital requirement of MSEs. Getting access a significant amount of money is most evident in informal sources than formal or semi-formal sources (Martin, 2001). Their categories can be

**Credit and saving unions:** are most often to salary and wage earners pertaining in urban areas, there by excluding the bulk of MSE operators. Although there is a continuous increase in the number of credit and saving institutions and members, it has entirely excluded MSEs.

**Cooperative societies:** are taken as group formation to reach out by many working institutions. In the Ethiopian context, membership in cooperatives has been long politicized and not preferred by many members. Even in the metropolis entrepreneurs are anxious of being members of a cooperative, as they referred to its bad experience (Wolday, 2002).

**‘Iqqub’:** A study by Dejene Aredo who examines the role and functioning of the ‘iqqub’ in Ethiopia. The ‘iqqub’ is a type rotating savings association with an element of chance in the awarding of the amount in each cycle. Basic principles and underlying procedures are analyzed in general and for a number of specific cases. The ‘iqqub’ is conceived as a form of traditional savings institution: The ‘iqqub’ is a form of saving institution in which weekly or monthly payments of a fixed sum are exchanged for the privilege of receiving a large sum at some point in the life of the group.

- The ‘*iqqub*’ belongs to the type of traditional financial institutions which

are included under the savings associations.

- The '*iqqub*' was a saving club combining a bank and lottery.

Iqqub' is widespread in Ethiopia, in many sectors and for many purposes, and said to have originated during the Italian occupation. Its continued spread is explained, among others, by the repressed character of formal institutional credit to the private sector. The iqqub' may involve fairly small amounts, as in predominantly rural areas for consumptive purposes, but may also involve large amounts, as for example among the big traders in Addis Ababa (Helmsing and Kolstee, 1993). Larger are more institutionalized with elaborate by-laws, employ staff, and have sophisticated mechanisms to compensate members for longer waiting times (which indicates non-zero interest rates) and have direct links with the banking system (to deposit receipts and use cheques). These compensatory mechanisms also reduce the importance of the element of chance in the awarding of the lot in any cycle and therefore make the iqqub' potentially more appropriate to finance Mses Credit needs. The design of financial policies and of MSE financial assistance programs should take the potential role of indigenous financial institutions such as the iqqub' into account (Ibid, 1993).

**'Idirs'**: are indigenous institutions collecting a specified set of money from their members to pay out a specified lump sum of money and assistance to a member, at his/her bad times especially at times of mourn. Despite the need to mobilize resources kept by the 'idir', they, so far, are not reported that they provided loan or assistance to business activities (Tewodros , 2005).

**Money-lenders**: covers a wide range of credit arrangements that differ across countries, with interest ranging from zero to as many as 100% a month (Aryeetey 2000). MSEs Use money-lenders as a last resort. Most of the informal moneylenders base their lending disciplines on a firsthand knowledge of the borrower (Gebrehiwot and Wolday, 2006).

**Own savings, relatives, and friends**: are the most important alternative sources of finance to MSEs in developing countries like Ethiopia. They usually extend finance as non-interest bearing loan based on intimate knowledge and trust of each other, making the need security in the form of collateral or guarantee low (Fasika and Daniel, 1997).

**Trade credit suppliers**: are significant sources of informal credit in an enhanced credit rating

system. Trade credit refers to loans suppliers extend to their customers in connection with product sales. They supply either input or cash advances to MSE operators. Enterprises may receive trade credit either as a substitute for or complement to bank credit. Trade credit has attraction feature of not being guaranteed by mortgage able assets, which is advantageous for enterprises lacking collateral assets. Enterprises could resort to trade credit both as a means of financing purchases (i.e., receive trade credit from suppliers) and promoting sales (i.e., grant trade credit to customers). Extending trade credit to customers may be important in sealing deals as well as become and remain competitive as it represents better terms of sales compared to requiring payment in advance or up front (sales promotion motive). Hence, enterprises could be engaged in trade credit for establishing good business relationships or for financing purpose. In the context of Ethiopia, it is reported that the practice of providing trade credit exists for either purpose (Gebrehiwot and Wolday, 2006). However, trade credit suppliers are unwilling to extend trade credits, the only option left for these enterprises is to depend on personal funds or turn to friends and relatives. This limits the amount of funds available for working capital and reinvestments in productive capacities like high use operating equipment and facility refurbishments.

### **2.1.6 DETERMINANTS OF ACCESS TO FINANCE**

Access to financing is recognized as the leading obstacle to small businesses growth in Ethiopia, alike most other developing and under-developed countries. Small businesses, in most cases, manage to start a business with resources from informal sector, but find it extremely difficult to survive and expand without further financial assistance from the institutional lenders (Fetene, 2010).

The formal financial institutions in Ethiopia have not been able to meet the credit needs of the MSEs. Since there is high interest rate and collateral requirement, most MSEs have been forced to use the informal institutions for credit. The main sources of startup and expansion finance or funds for most MSEs in Ethiopia are personal savings followed by iqub/idir, family and friends/relatives. Nevertheless, the supply of credit from the informal institutions is often so limited to meet the credit needs of the MSEs (Admasu 2012).. Generally, different literature reveals that the main major determinants that affect access to finance of MSE fall under Entrepreneur characteristics, Firm level characteristics and Institutional characteristics.

### **2.1.6.1 Entrepreneur Level Characteristics**

The personal characteristics of the owner-manager make a difference to the firm's ability and likelihood of accessing external finance (Irwin & Scott, 2010; Cassar, 2004). Vos et al., (2007) found that younger owner– managers tend to use more bank overdrafts and loans, credit cards, own savings, and family sources than older owners who appear to be more dependent on retained profits. Mijid (2009) found higher loan denial rates and lower loan application rates among female entrepreneurs. Coleman (2007) also provided evidence of credit discrimination against female entrepreneurs as they were more frequently charged higher interest rates and asked to pledge additional collateral in order for loans to be granted. Explanations given in the literature for differences between men and women entrepreneurs with respect to access to finance can be categorized into discrimination, abilities and preferences, and competition (Harrison & Mason, 2007).

A study by Bates (1990) examining the impact of owner–manager's personal characteristics on SME longevity across a wide sample of SMEs owned– managed by men across the US between 1976 and 1986 concluded that owner–managers who had higher levels of education were more likely to retain their firms operating throughout the period of study. He further emphasized that the level of education of entrepreneurs is a major determinant of banking loans amounts offered to SMEs. As for the demand side, Storey (1994) asserts that higher levels of education provide entrepreneurs with greater confidence in dealing with bankers and other funders when applying for loans.

### **2.1.6.2 Firm Level Characteristics**

According to Mabhungu 2011, formality, value of assets, business sector, operating period, financial performance and size are all important factors in determining micro and small enterprises 'access to finance. Financial institutions are more likely to approve loans to firms that are able to provide collateral and to those firms that have established long-term relationships with lenders. Due to the existence of asymmetric information, banks base their lending decisions on the amount of collateral available. Collateral reduces the problem of uncertainty, since the lender can theoretically recover some, or all, of his loan in the event of default. Moreover, the borrowers will find it costly to put valuable collateral if they intend to default with the proceeds of the loan, because they will lose their collateral. Thus, the collateral requirement can also help to weed out

rogues from honest borrowers, leaving only those bona-fide applicants who fully intend to repay the loan.

According to Martin and Daniel (2013), firm age was found to play a role in firms 'access to finance. More specifically, firms that are older were found to have more access to finance. These results were not unexpected because older firms have the network capital generated overtime and also credit history that can be used by lenders to assess their credit worthiness. In contrast, younger firms may lack the necessary connections on the providers of finance and also the historical performance of the firm may block.

Klapper et al. (2002), suggest that younger enterprises (those established less than four years), are more reliant on informal financing and far less on bank financing. This is supported by different authors (Cassar, 2004; Storey, 1994). From another angle, the extent to which firm size can impact the availability of finance to the firm was measured by Petersen and Rajan (1994). They argued that as firms grow, they develop a greater ability to enlarge the circle of banks from which they can borrow. They then provided evidence that firms dealing with multiple banks and credit institutions are nearly twice as large as those with only one bank. Martin and Daniel (2013) suggested that the reason for the effect of size of the business on the ability to access finance is that larger firms are likely to have collaterals that act as a security in securing finances. The effect of industry classification on the capital structure of Ghanaian SMEs was examined by Abor (2007). The results of the study revealed some differences in the funding preferences of the Ghanaian SMEs across industries. SMEs in the agriculture sector and medical industries rely more on long-term and short-term debt than their counterparts in manufacturing. Abor (2007) further concluded that short-term credit is more used in wholesale and retail trade sectors compared with manufacturing SMEs, whereas construction, hotel and hospitality, and mining industries appear to depend more on long-term finance and less on short-term debt. Abor (2007) found that SMEs in the agricultural sector exhibit the highest capital structure and asset structure or collateral value, while the wholesale and retail trade industry has the lowest debt ratio and asset structure.

### **2.1.6.3 Institutional Level Characteristics**

Credit terms considerably influence financial decisions of SME borrowers. Credit terms are conditions under which credit is granted. The conditions involve interest rate, credit limit, and loan period. Credit terms control the monthly and total credit amount, maximum time allowed for repayment, discount for cash or early payment, and the amount or rate of late payment penalty (Richard, 2010). Rate of interest is a key determinant of access to finance as it influences investment.

Whenever interest rate rises up, investment will eventually fall, this is because with higher interest rate the possibility of making profit out of investment is very low; hence, high interest rate reduces the marginal efficiency of capital. On the contrary, bank charges interest to investors out of which certain percentage will be paid to savers as deposit rate. At higher deposit rate saving will be attractive and similarly banks will extend more loans, but investors will reject further loans as interest rises (Sacerdot,2005) revealed that the type of financial institution and its policy will often determine the access. What is displayed in form of prescribed minimum loan amounts, complicate application procedures and give restrictions on credit for specific purposes.

## **2.2 EMPIRICAL LITRATURES**

Stephanou, C., & Rodriguez, C. (2013). Conducted a research entitled “challenges of Financing to Small and Medium-Sized Enterprises (SMEs) in Colombia”. The main objective of the paper was to shed light on current trends and policy challenges in the financing of small- and medium sized enterprises (SMEs) by banks in Colombia. The paper was motivated by the well documented financing gap for SMEs in many countries and importance of SMEs in overall employment and economic growth, as well as their financial constraints and perceived lack of access to finance.

The paper was primarily based on data collection and interviews with a representative sample of Colombian credit institutions and other relevant entities by focusing on bank financing to SMEs by analysing why, how, and to what extent banks lend to this segment, the business and risk management models they use, and the factors constraining their ability to provide more financing.

Accordingly the study tried to found four issues. Challenges of financing to SMEs has grown significantly in recent years and it is becoming a strategic segment for Colombian credit institutions, government programs to support SME financing have also been cited as contributing to market growth, Important institutional and policy constraints to SME lending remain but are not yet binding and The business model for SME lending is still relatively underdeveloped, but greater sophistication is expected as the market matures constraining their ability to provide more financing.

Augusto et al., (2008) in their study of “Bank Involvement with SMEs: Beyond Relationship Lending” in the Latin America and Caribbean region have found three main issues based data from 12 developed countries. They have identified that banks interested to engage with SME rather than through relationship lending and that large banks allocate a much lower proportion of their assets to small business loans than small banks during their literature review. After the survey of countries’ SMEs and banks conducted by World Bank, FRS and IFC using the designed questionnaire and detail interview with top management as tool for collecting both qualitative and quantitative, they have summarised by table and conclude the following three issues.

The evidence presented in the paper significantly questions the common wisdom that SMEs are underserved because their chronic opacity makes them substantially (if not entirely) dependent on relationship lending. The new evidence in this paper from 12 developed and developing countries suggests that all kinds of private banks (large, small, domestic, and foreign) view SMEs as a strategic sector and are expanding or planning to expand their operations aggressively in this segment. Thirdly as a consequence, the market for SMEs is becoming increasingly competitive, although far from saturated. Banks are developing new business models, technologies, and risk management systems to serve SMEs.

Abdulaziz and Adrew (2016) conducted research entitled determinants of SME access to finance. The main objective of the study was to identify the determinants of successful bank loan grant to SME in Libya. Secondary data was collected from different firms in the country and regression model was used to analyse the secondary data, Variables of the study was size of the SMEs in

terms of employment, sector of operation, age of the business, and level of education of the owners/managers. Based on the finding from the regression of data study have concluded that all other things being equal, more educated managers and firm with strong banking relationship are more likely to be granted loans, while the firm with older owner managers, larger firm, and firm in service sector are less likely to be granted loans. workshop appears to have little influence on whether loans are granted. These findings suggest that banks loans in Libya are largely made on the strength of the relationship between the bank and the SME rather than the financial statement approaches to bank lending found in more developed economies with stronger banking sectors.

Alyosius and Lubinda (2013) in their study of the challenges of financing in Zambia tried to assess the development and challenges of the same. The paper has three objectives. The first objective was to determine the trends of the challenges of financing in Zambia. The second objective of the study was to assess the contribution of the legal and regulatory framework to the development of the small business sector in Zambia. Finally, the study sought to highlight the major challenges faced by the accessing finance market in Zambia. The study employed a qualitative research approach and used primary data from nine non-bank leasing companies, Bank of Zambia officials and Ministry of Finance officials. Secondary data was collected from several financial sector and leasing publications, reports and dissertations. The result of the study revealed that the prudential performance of the sector has been unsatisfactory. The study discovered that the industry performed average in capital adequacy, but performed poorly in asset quality, earnings and liquidity performance. It has also found out that the regulatory system in Zambia was still fragmented and operating in an environment with insufficient legislation. The study further revealed that the regulatory body had not yet put enough effort in promoting accessing finance markets in Zambia.

The study noted that there is no accessing finance specific legislation in the country. The main supervisor, Bank of Zambia, lacked technical and supervisory capacity to adequately supervise the industry. According to the study, the major challenges experienced by the providers in Zambia included the lack of finance policy and finance laws, lack of skilled staff, absence of trainers and poor supply chain systems that exist in the country. On the other hand, the study didn't included key stakeholders such as tax authority, investment agencies, and equipment suppliers to strengthen and validate the findings.



Ahmed et al. (2003) conducted a research entitled access to finance in Pakistan: Problems and Prospects. The main objective of this paper was to identify the major issues adversely affecting the performance of financing in particular and financial sector in general.

Accordingly, the study tried to identify two general issues pertaining to macroeconomic scenario and four specific challenges of financing in Pakistan. Regarding the first two general issues the paper discusses in detail about the adverse effect of economic slowdown and volatility of interest rate on the activities of financial institutions. On the other, the four specific challenges explained in the paper include: resource constraints (funding problem), non-availability of level playing field, lack of innovative products and tax related challenges. It was also argued that in order to improve the near future demand prospects in particular, the access to financing need to develop innovative products along with encouraging SMEs of plant and equipment relating to priority sectors of the economy .

Chowdhury et al., (2013) carried out research on Problems and Prospects of SME Financing in Bangladesh aimed at analysing the potential of SMEs in the economy of Bangladesh. After result from survey of 100 SME business were summarised by table three issues have concluded. In the survey, it was found that 20% mentioned that collateral requirement is a major obstacle to secure loans for them.

On the top of this, 30 percent has stated about the long and monotonous paperwork required for processing of loans as a major obstacle. More than 20 percent of the small and medium enterprises were found to have no training in terms of preparing a sound business plan for taking credits. In the survey, though on average most of the loan is taken from financial institutions like BASIC, RAKUB and other support services from private institutions, most of the investors articulated the view of getting more financial support from institutions that would completely deal with SMEs.

Yared, (2014) have studied research entitled Small and Medium Enterprise in Ethiopia: Challenges and prospects. The aim of the paper was to Identify and analyse the national policy challenges that are inadvertently undermining the implicit development of SMEs, to assess the

credit situation in the country corresponds to the financing needs of SMEs across the world in their bid to expand and to provide policy suggestions and recommendations those target the challenges and constraints of SMEs.

The study have gathered both primary and secondary using interview and document review as data collection tool and descriptive and explanatory way of analysis technique is used for discussion and analysis. Data were summarised in tabular. Accordingly the findings of the study was that majority of the constraints and problems in relation to the sector appears from government policies and development strategies.

Ekpu, (2015). Has conducted the research entitled determinants of bank involvement with SMEs springer briefs in Finance. The demand and supply side survey was used by the study as methodology of data collection. The study incorporates major theoretical works on loan pricing, collateral determination and the value of relationships in loan contracting. Findings from the research reveal that the determinants of risk premium on SME loans are largely connected with factors that underline the opacity and riskiness of SMEs and are also associated with lender factors such as cost of funds and managerial expenses associated with loan appraisal and disbursement.

In addition to these the study have found that banks generally charge higher differential interest rates to younger SMEs than to older, larger and more established customers, due to the former's relative opacity, perceived risks and uncertainties and high failure rate. Clients with longer relationships with their bank tend to benefit from lower interest rates than first-time customers, supporting the notion that relationship lending generates valuable information about borrower quality.

Anything determines the likelihood of requesting collateral from SMEs is significantly related to the borrower's risk characteristics, such as firm size, firm's age or capacity.

Loan size, firm size and borrower's credit rating tend to also determine the likelihood that a bank will request full or partial collateralization. Finally, the study underlines that determinants of loan contract terms are also influenced by external and business environment factors such as the business cycle, monetary policy and the level of bank competition.

Okoth, (2015) have conducted the research entitled "Challenges of financing Small and Medium Enterprises [SMEs] In Equity bank Branches in Kenya. The study was aimed seeking to determine the challenges faced by Equity Bank branches in financing SMEs in Kenya and examine how it's trying to address these challenges. The research design for this study is a cross sectional survey design and data collection involved the use of questionnaire. The data was presented through summary statistics (percentages, mean standard deviation) to measure the interrelationship between variables.

Major challenges faced by the banks as revealed by the study in the process of lending to small businesses were mainly; lack of banking /credit history to allow them access the funds easily from commercial banks, they have no valuable collateral to act as security for their financing, non-registration of businesses; lack of financial statements required for financing and lack of keeping proper books of accounts and products offered by its branches might not be preferred by the SMEs as most of them might not focus on their co- business operations.

Cotie, (2017) has conducted the research entitled "the Challenges of Financing SMEs in the Ashanti region case study on Stanbic Bank (GH) Ltd. The main objective of the study was to evaluate the challenges and extents of Financing of SMEs within the Ashanti region of Ghana taking cognizance of the role and contributions of stanbic bank Ghana limited. The study gathered data from staff of the business banking/SME banking unit of stanbic bank and from owners and managers of SMEs who does business with bank. Primary data were gathered using questionnaire and personal interview while secondary data were from journals, textbooks, handbooks, manuals, editorials, and from informal discussions with experts and colleagues. Variables of the study were management of SMEs, default rate, monitoring of regulatory, relationship of bank with SMEs, conditions of extending credit facilities, sector of SMEs business, and period of existence of SMEs doing business with the bank.

Based the data gathered the study have found that the relationship between the bankers and their respective SMEs is generally very good. Years of existence, past and projected cash flow, credit history, lines of business, collateral and business location are identified as by the study as major conditions or criteria considered when the bank is extending credit to SME customers. Three major challenges (management, high default rate and monitoring) that militate against the SME

Banking Unit of Stanbic Bank were identified. On the other hand the study have identified the six main industry from which SME financed by Stanbic are operating. These are Food processing, bakery, wood products, furniture works, metal works and machinery works; with the Food processing sector being the most patronized sector. Finally the research showed that 50 percent of SMEs registered their firms with the Registrar General and majority did so as sole proprietor, while Private Ltd and Private partnership are in the minority.

To summarise, the study have reviewed both theoretical and empirical evidences from different sources. In theoretical section we have started by definitions given for SME by different scholars, institutions, and government units and came through different challenges of financing concepts, rationale and principles of small and micro business enterprises, SME financing aspects in Ethiopia along with regulatory framework.

Finally the researcher has reviewed the empirical evidences which are highly related to the research topic. During the reviewing time the study have given attention to the objectives of the study, statement of the problem, objectives of the study, Variables of the study and methodology employed to conduct those empirical papers in order to identify the gap and try to fill that gap.

Although various empirical studies have been conducted to assess the problems and prospects in challenges of financing in different countries of the world, there is a dearth of empirical study that examines the data on Challenges of Small and medium enterprises financing aspects particularly in Ethiopia. I would say this research gap implies a lack of empirical studies from the perspective of challenges that development bank of Ethiopian will face in involving with Small and Medium enterprise financing. Therefore, this study attempted to bridge this gap and elaborate the challenges of the SME financing industry in Ethiopia specifically in medium and small size enterprises.

In reality, literature on MSEs in Ethiopia especially in Jimma town is very little and most of the available studies were not conducted in line with sources and challenges of finance for micro enterprises. However, this research were tried to assess sources and challenges of finance for MSEs by targeting and deeply investigating those operators are engaged in manufacturing, construction, services, trade and urban agriculture activities in Jimma town.

## **2.3 OPERATIONAL DEFINITIONS OF THE STUDY**

Micro and Small Scale Enterprises (MSEs) are lifeblood of most economies. To be successful this and other business sectors, finance plays a major role in any aspect of business operation. As far as micro and small enterprises (MSEs) are concerned as part of business enterprises, they need finance to start up, expand, diversify and for working capital of the business firms. Without finance, no one business enterprise can achieve its objectives. Finance is the backbone of any business enterprise (Mckernan and Chen, 2005) including for MSEs 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 (World Bank, 2008). Availability of finance determines the capacity of resources which in turn greatly influence the viability and success of a business. Securing capital for business start-up or business operation is one of the major obstacles of every entrepreneur, particularly those in the MSE sector (Solomon, 2009). Access to financing is recognized as the leading obstacle to small businesses growth in Ethiopia, alike most other developing and under-developed countries. Small businesses, in most cases, manage to start a business with resources from informal sector, but find it extremely difficult to survive and expand without further financial assistance from the institutional lenders (Fetene, 2010). The formal financial institutions in Ethiopia have not been able to meet the credit needs of the MSEs. Since there is high interest rate and collateral requirement, most MSEs have been forced to use the informal institutions for credit. The main sources of startup and expansion finance or funds for most MSEs in Ethiopia are personal savings followed by iqub/idir, family and friends/relatives. Nevertheless, the supply of credit from the informal institutions is often so limited to meet the credit needs of the MSEs (Admasu 2012).

Therefore based on the above literature the main intent of this research is only concerned with financial source and challenges, from this perspectives in order to set up and expand their operations from which financial source( formal, semiformal and informal ) MSE needs finance and to determine whether age of operator ,educational level of the operator ,the fixed asset enterprise possess, duration of business, number of employee , business sector, amount of interest rate, repayment period, lending procedure and availability of information are the determinant/challenges to access finance Generally, MSE performance is success if and only if the above source of finance can support enterprises to set up and expand their operations, build up

new products, and invest in new staff or production facilities without more concerning on the above determinant variables of access to finance . And it is failure if the financial sources of finance are stricken on the variable mentioned above Performance: are the overall activities and operations performed by Mses Operators in strengthening their enterprises As Walker and Brown (2004), small business performance can be measured by financial and non- financial criteria such as increases in profit or turnover and/or increased numbers of employees and autonomy, job satisfaction or the ability to balance work and family responsibilities respectively.

Generally, from the above mentioned reviewed literature the researcher conclude that even though there is no commonly used definition of MSE across the countries of the world. However, all the definitions have taken the common criteria such as the number of employees, paid up capital, sectorial category, market share and the management entity. Despite the controversies in efficiency and poverty reduction, literature shows small business plays a vital role in the socio economic and political contribution in both developed and developing nations. Small business contributes to equitable distribution of wealth and decentralization of economic power. A small business requires less capital and they are labor intensive in their nature

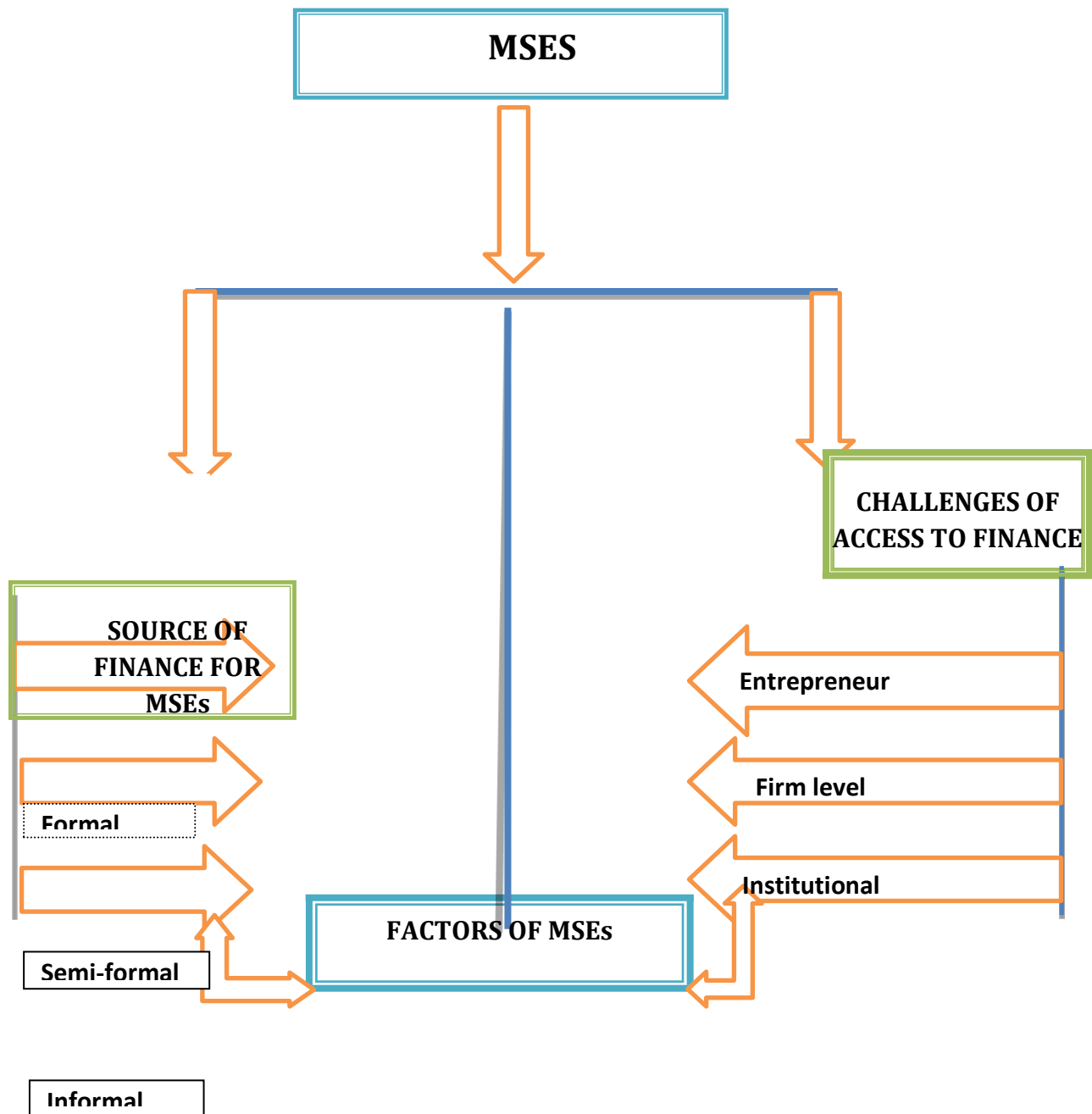
Although, MSEs are major contributors to the gross domestic product (GDP) and employment in economies around the world, their financial needs are underserved, which determines the capacity of an enterprise in a number of ways, especially in choice of technology, access to markets, access to essential resources which in turn greatly influence the viability and success of a business. Securing capital for business start-up or business operation. Generally based on degree of formality of operating within a given financial system financial source can be classified as formal, semi-formal and informal sources of finance. Meanwhile the main major determinants that affect access to finance of MSE fall under Entrepreneur characteristics, Firm level characteristics and Institutional characteristics.( Adrew ,2016)

## **2.4 CONCEPTUAL FRAMEWORK OF THE STUDY**

A conceptual framework is a product of qualitative process of theorization which interlinks concept that together provides a comprehensive understanding of a phenomenon or phenomena (Jabareen, 2009). The concepts that constitute a conceptual framework support

one another, articulate their respective phenomena, and establish a framework-specific philosophy that defines relationships.

Figure 2. 1 Conceptual frame work of the study



Source: own compiled from reviewed literature

# **CHAPTER THREE**

## **3 RESEARCH METHODOLOGY**

### **3.1 DESCRIPTION OF THE STUDY AREA**

Jimma is the largest town found in south west Ethiopia, located in the oromia region; it is commercial center for coffee production region. The population of the town was more than 195,000 until 2008(CSA). According to the current used master plan, Jimma town has the total area of 100.2 km<sup>2</sup> the name of today's Jimma was derived from Mecha-Oromo clan called JimmaWayu. These people had started to live in the main quarters of the town namely Jiren, Hirmata and Mendra. In the 18 century the kingdom of Jimma which was one of the five Gibe States (Shanan Gibe) next to Gera, Guma, LimmuInariya and omma was established by Abba Jifar

The history of Jimma town and its growth from its foundation until 2008. It explores social, economic and administrative themes, but also attempts to show the interrelationship between these themes. The town of Jimma evolved from being the home-town of a relatively homogenous society and culture into a place of residence for a diverse and increasingly cosmopolitan population. Economically, the story of Jimma is one of both continuity and change. It is a story of continuity because Jimma, which had been a center of trade from the very beginning, continued. There was significant change, however, because unlike the previous decades in which Jimma had served as a point of exchange or transit for elite goods that mostly originated from beyond the borders of the Oromo Kingdom. The town developed into the chief center for the collection, organization and export of a cash crop that was grown locally (coffee).

Economic change, therefore, resulted in both production and exchange. The social, economic and administrative history of Jimma is closely intertwined, however. The mixture of peoples and cultures, as well as the nature of the urban social institutions that evolved in the town, are closely tied to “the cash crop revolution”, which brought streams of permanent and temporary residents to the town; the evolution of the town into a chief administrative center, as well as the introduction of



somewhat peculiar administrative and fiscal institutions, came about, at least in part, as a result of the location of the town in the heart of the “coffee country”, as southwestern Ethiopia came to be known. In short, both the urbanity and the urbanization of Jimma can be explained by the story of coffee production and trade.

### **3.2 RESEARCH DESIGN**

It is known that several options are available in social research but all approaches are not appropriate to all research study, it depends largely on the objectives of the study. The study was employed a descriptive research design to conducted the study. Herbert W Seliger; ElanaShohamy (1997) stated that, descriptive study is appropriate when a researcher wants to look into a phenomenon or a process in its natural contexts in order to get its overall picture instead of taking one or some of its aspects and manipulating it in a simulated or an artificial setting. Being a descriptive design, the researcher was used a quantitative approach.

### **3.3 DATA SOURCES AND GATHERING TOOLS**

The researcher used both primary and secondary sources of data. Primary data are the data which is directly collected for a specific purpose of investigating the research problem at hand (Dr.sue Greener. (2008). Whereas secondary data was a data one that have not been collected for the immediate study at hand but for purposes other than the problem at hand. The primary data was collected from micro and small enterprise operators and the Secondary data gathered from the report of Jimma town Micro and Small Enterprise office and from the published and unpublished materials.

In order to collect the primary data from the target source, a self-administered questionnaire were used. The questionnaire were first prepared in English and translated into Amharic by researcher for those who were blinded for English version to check consistency of questionnaire.

### **3.4 SAMPLING AND SAMPLING TECHNIQUES**

The study employed stratified sampling techniques proportion to the size in order to address all group of strata classified in terms of sector and random sampling was used for the selection of one

respondent from the strata that reports on behalf of the selected group based on lottery methods. The target population of the research is Micro and small enterprises located in Jimma town. Based on Yemane (1996) determination of sample size formula, the researcher can get grand total sample of 378 at 95% confidence level and 5% precision level as described below

- $n = \frac{N}{1+Ne^2}$
- Where
- n Sample size
- N Total population MSEs = 7218
- d Non-response rate: 5%
- e Confidence level : 5%

$$N=7,218 \quad n=7,218/1+7,218(0.05)^2$$

$$7,218/1+7,218(0.0025)$$

$$7,218/1+18.05=7,218/19.05=378.02$$

$$=378$$

By using this formula the researcher used 378 sample sizes out of the total population of 7,218.

Sample size from each sector type of MSEs is determined by using the formula shown below.  $n_h=(N_h/N_s)n$  where  $n_h$  is sample size from each stratum,  $N_h$  is total population in each sector, and  $N_s$  population of the sum of strata for the study (7218)  $n$  is total sample size from the study population (378) using this formula, sample the computed sample size from each stratum is provided in table below. From each stratum, using proportional quota sampling techniques sample sizes were computed as indicated below.

Proportionate sample size from each stratum

Table 3. 1 Proportionate sample size from each stratum

S,no	Enterprise sector	Total Number of Enterprise	Sample size from the total population	Proportionate sample size from each MSEs (N <sub>h</sub> /N <sub>H</sub> ) Sample
1	Construction (strata1)	695	37	(695/7218)*378=37

2	Manufacturing (strata2)	1,418	74	$(1,418/7218)*378=74$
3	Service(strata3)	1,852	97	$(1852/7218)*378= 97$
4	Manufacturing (strata4)	2,254	118	$(2254/7218)*378=118$
5	Urban farming/agriculture(strata5)	999	52	$(999/7218)*378=52$
Total		7,218	378	378

Source: Own survey data computation 2020

### 3.5 DATA ANALYSIS

The data was collected; with the quantitative data collected through the questionnaire, a descriptive statistical analysis method was used. Descriptive research involves gathering data that describes events and then organizes, tabulates, and describes the phenomena. To process the data from different angles, the researcher used all the necessary data, and finally the raw data was organized and grouped based on common characteristics. As a result, the data obtained via the questionnaire was tallied and the frequencies were converted into percentages. Tabulation methods, description of facts based on statistical analysis like latest version of SPSS (Statistical Package for Social Science), percentages, and graphs with explanations.

### 3.6 VALIDITY OF THE STUDY

The researcher was selected participants randomly so that characteristics were the probability of being equally distributed and recruits large sample to account or compare these outcomes. The researcher was used the same instrument for pre-test and post-test measures. To guard against this, the researcher was conducted pilot studies to establish trust and respect with the participants. Hence, a more cooperative atmosphere, which was increases the validity of the subjects' responses.

### **3.7 ETHICAL CONSIDERATIONS**

Letter of cooperation would obtain from Jimma zone micro and small enterprises development office to the concerned MSEs established body of Jimma town. Verbal and informed consent would obtain from the owners/managers of the study by informing the purpose of the study and researcher use the ideal way of recording, storing and retrieving. Regarding the right to privacy of the respondents, the studies maintain the confidentiality of the identity of each participant. In all cases, names would keep confidential thus collective names like ‘respondents’ were used.

## CHAPTER FOUR

### 4 DATA PRESENTATION, ANALYSIS AND DISCUSSION OF RESULTS

#### 4.1 INTRODUCTION

This chapter presents the result and analysis of data collected through questionnaire. This chapter organized into four parts, the first part consist presentation of the demographic profile of respondents, the second part deals with general information about the enterprises, the third part consists of financial information of MSEs and the last part of this chapter deals on challenges of MSEs faces to get loan respectively by using descriptive statistics frequency, percentage, and graphs and etc.

#### 4.2 SAMPLE RESPONDENT'S RESPONSE RATE

Table 4. 1 Response rate of the sample respondents

<b>Characteristics</b>	<b>Variable</b>	<b>Frequency</b>	<b>Percentage</b>
<b>Response rate</b>	Completed and returned	360	95.00
	Not returned	18	5.00
	Total	378	100.00

Source: Own survey data computation 2020

Regarding to the response rate of the respondents from the total 378 questionnaires were distributed among these 360(95%) questionnaires were returned and answered correctly, the remaining 18(5%) are not returned by the respondents. Therefore the analysis and interpretations of 360 respondents were discussed under here as followed.

#### 4.3 DEMOGRAPHIC CHARACTERISTICS OF THE RESPONDENT

Regarding to demography of sample respondent's, the researcher presented the findings here under

by table

Table 4. 2 Demographic characteristics of the respondent

<b>Age of the respondent</b>	<b>Frequency</b>	<b>Percent</b>
15-25	65	18.10
26-35	183	50.80
36-45	88	24.40
46-55	22	6.10
more than 56	2	0.60
Total	360	100.00
<b>Educational status of the respondent</b>		
No formal education	9	2.50
Primary	13	3.60
Secondary	112	31.10
TVET	55	15.30
Diploma	82	22.80
Degree	84	23.30
masters and above	5	1.40
Total	360	100.00
<b>Sex of the respondent</b>		
Male	255	70.80
Female	105	29.20
Total	360	100.00
<b>Marital status of the respondent</b>		
Married	168	46.70
Single	172	47.80
Divorced	4	1.10
Other	16	4.40
Total	360	100.00

Source: Own survey data computation 2020

As we have seen from the above table most of MSEs are operated by adulthood ranging from 26-

35 which is about 183(50.83%) and followed by middle age ranging from 36-45 which is 88(24.40%) and also the table shows 18.10(65) of sample respondents are in between age of 15-25 and 6.10%(22) sample respondents are in between age of 45-55 and the rest of sample respondent are above 56 years old which is about 0.60%. Almost 93.30% of the sample respondents fall below an age of 45 years indicating that it is the younger part of the population that are actively organized and operating as MSEs than those found in the older age. They are probably those who can easily understand any guidance provided to them by the support institutions.

The study also shows that about 37.20% of the sample respondents range from below high school to high school complete, this implies that the educational coverage of government activities is also need to be swift and uninterrupted however the participation of TVET and Diploma graduate in MSEs was 38.1% of the total respondents. This implied that it is almost pointing to the direction of the government strategy that encourages graduates to be organized in MSE. The result of this study was in line study conducted by Goedhuys and Sleuwagen (2000) that argue higher education not only raises enterprise performance, but also increases outside options such as wage employment. Lower education and vocational training significantly influenced the likelihood of being entrepreneurs rather than wage employees

The table above revealed that 70.80% of the selected sample populations were males and the rest 29.20% were females. This implied that most of the owners of MSEs were found to be males, hence, the involvement of female MSEs operators were limited, it is almost less than one third of the sample respondents. Even if there is a clear message to encourage females in the mission statement of Jimma Micro and Small Enterprises Development Agency; but the involvement of females is still poor and it needs close and proper attention towards them. MSEs are assumed to be the basis for medium and large industries, this strategy will not meet the ultimate goal in the absence of females.

Lastly, the above demography table clearly shows that most of the sample respondents were single (47.80%), followed by married (46.70%). this implied that MSEs have no more financial sources, because they have no at least two families, i.e., the husband and wife side. And as if peoples begin to be married, they have the probability of good saving habit there by financing their own MSEs properly. Similarly, they will be good in synergy and the chance of having collateral increases.

But, this does not mean that married owners are overlooked, because those owners may have more dependents and in turn it may consumes the retained earnings of MSEs.



## 4.4 GENERAL INFORMATION ABOUT THE ENTERPRISES

Under this section the researcher engaged to know the business sector, Number of Staff Employed, Number of years in Business, legal forms, motivation to start business, working premises, fixed asset of MSEs and major challenges of MSEs.

### 4.4.1 Sector of the enterprise

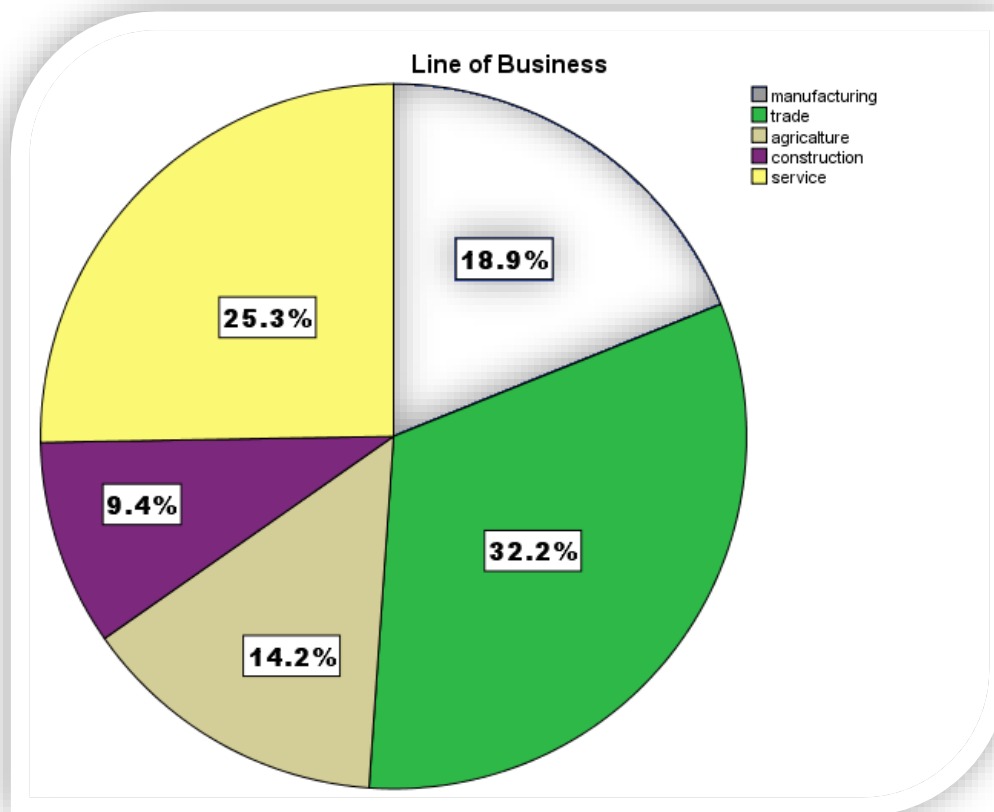


Figure 4. 1 line of business in jimma town

Source: Jimma town MSEs Office

As we have seen from the above pie chart, the major business sectors in which the respondents are organized were the trade sector (32.2%) followed by service sector (25.3%) and with the lowest number of MSEs in Constructions sector is (9.4%). Urban agriculture sector constitute 14.2% of sample respondents whereas the Manufacturing sector accounts for 18.9% sample operators. The proportions of MSEs in all sectors are not uniform for all sectors and particularly low in constructions, manufacturing and urban agriculture sector respectively which was the main stay of the country.

The study result shows that the strategy of the national and local government policy is not an encouraging and attractive in attracting individuals to those sector.. This is probably due to the fact that those sectors are capital intensive and also requires infrastructural developed land that the town administration cannot afford.

#### 4.4.2 Number of years in Business

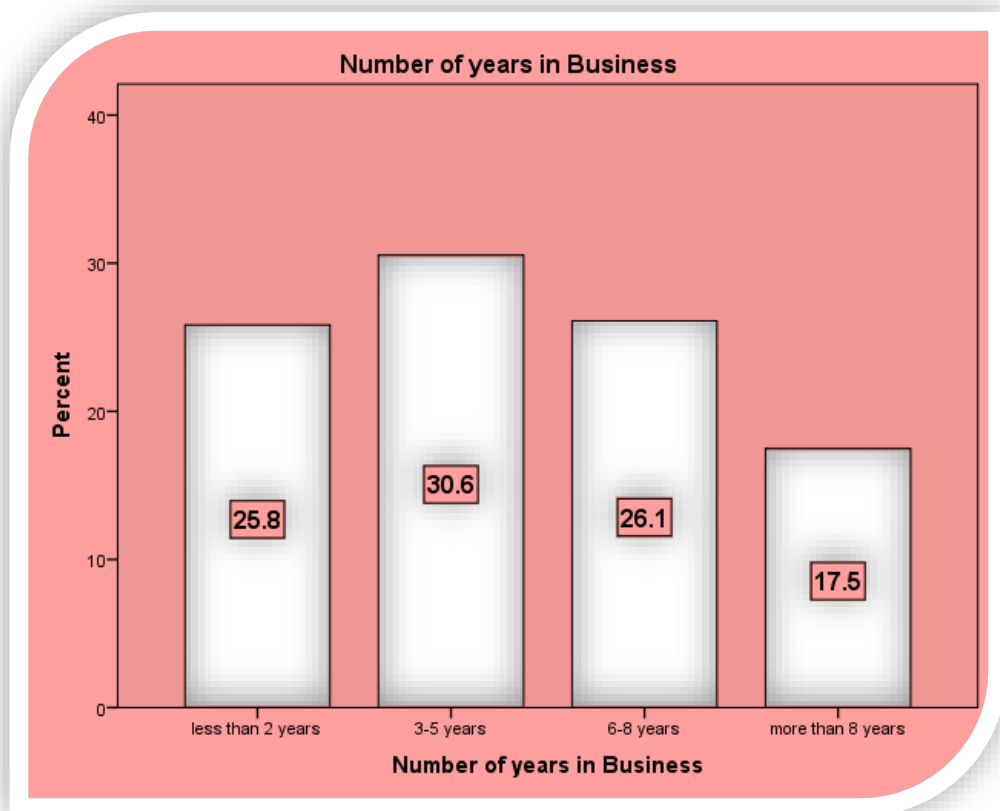


Figure 4. 2 Numbers of years in business  
Source: Own survey data computation 2020

Figure 4.2. revealed that from the total sample respondents 30.6% have business experience of ranging from three to five years which is the largest sample respondents work experience, whereas 26.1% is ranging from six to eight years, 25.8% is less than two years and the rest were more than 8 years which is 17.5% , the result shows that 56.4% of sample respondents were operating their business below five years, this also indicates that most of MSEs experience were in infant stage, this also indicates that they need further support in terms of capital, sharing experience, announcing with technology and other all dimensions.

#### 4.4.3 Legal form of business enterprise

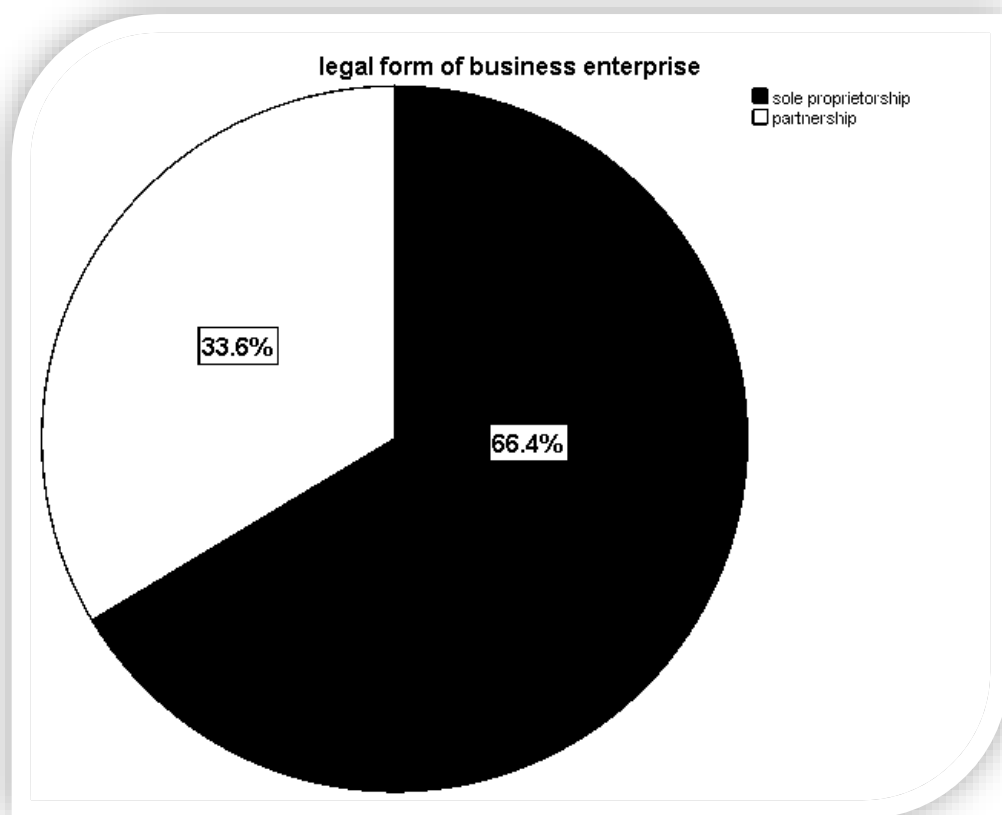


Figure 4. 3 Legal form of business enterprise  
Source: Own survey data computation 2020

Regarding to legal form of business enterprise, the survey result shows that 66.4% of sample respondents were started their business only by themselves rather collaborating with other, this implies that most of business operating in MSEs sectors were formed as sole proprietorship, whereas the remaining sample respondents were emerged with other to start their business operation.

#### 4.4.4 Motivation to start your business

The under pie chart discussed on MSEs owners reason for getting in to businesses.

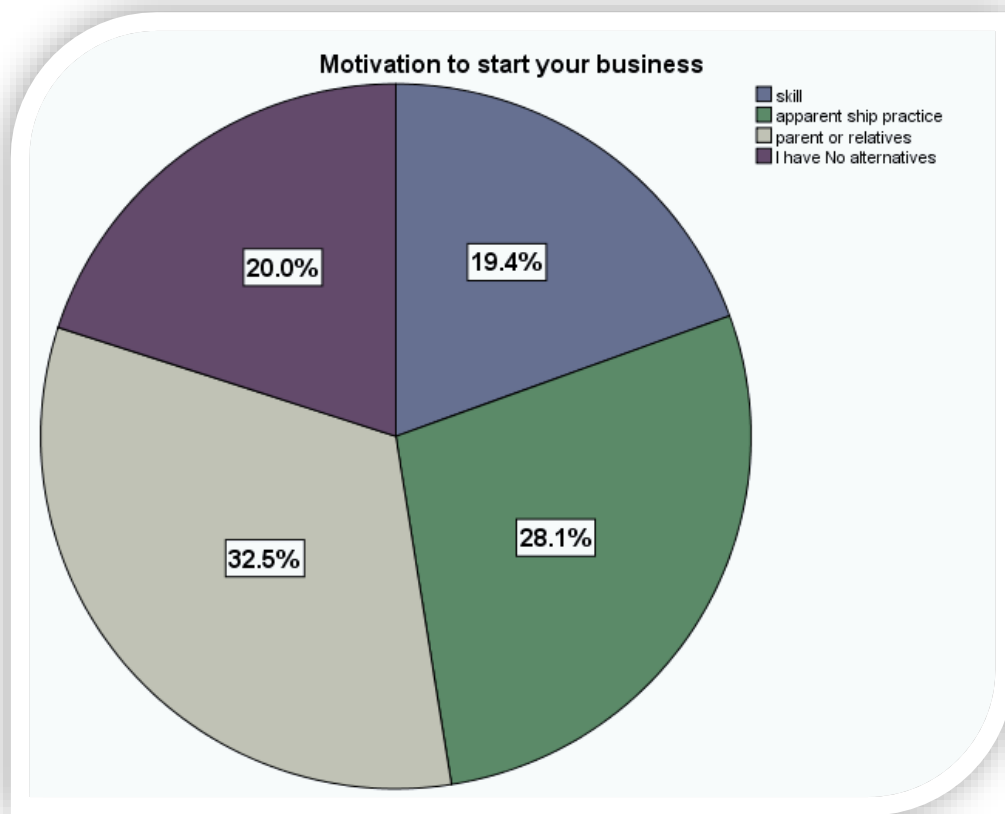


Figure 4. 4 Motivation to start business  
Source: Own survey data computation 2020

The above table 4.2 revealed out that from the reason that motivate respondents to start their business 28.1% replied as entrepreneurship experience, 19.4% were as skill, 32.5% were as parents/relatives advice and support and the remaining 20% were as had no alternative choice. According to Tiruneh Abebe, to begin businesses by entrepreneurship and skill in this business may be encouraging because those owners have an experience in different dimensions of the business and could be helpful in their current and/or future businesses opportunities. But from the total sample respondents large number of owner started their business by family and relatives advice and support rather than skill and entrepreneur experience, this indicates that MSEs needed to upgrade their experience through formal and education and training.

#### 4.4.5 Working premise of business enterprise

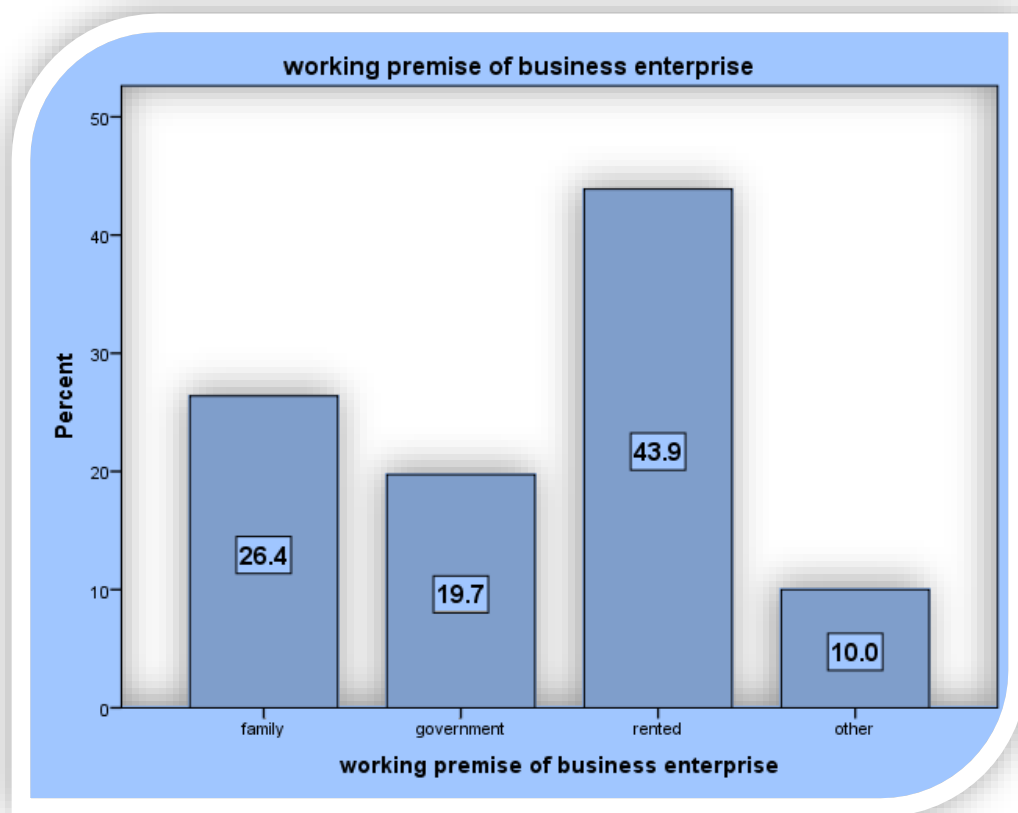


Figure 4. 5 Working premise

Source: Own survey data computation 2020

In line with working premises the study found Significant proportions 43.9% which is almost half of total sample respondents are operating their businesses in rented premises, and followed by 26.4% from their families premises, and 19.7% in government buildings which is no payment at all till now even if it is seated on the strategy, From this one can understand that most MSEs are working at rented premises and high rental charges have impeded the success of many MSEs as some charges are higher than the capacity to pay ,this has increased costs and resulted in poor sales and negative cash flows, thus minimizing the chance of their performance, One of the desires of most participants in MSEs is to save on costs and this includes saving on rental; for them higher disposable income now is more important than a better quality premises.

#### 4.4.6 Types of fixed asset owned by MSEs

This section illustrate that fixed asset owned by MSEs in their business entity

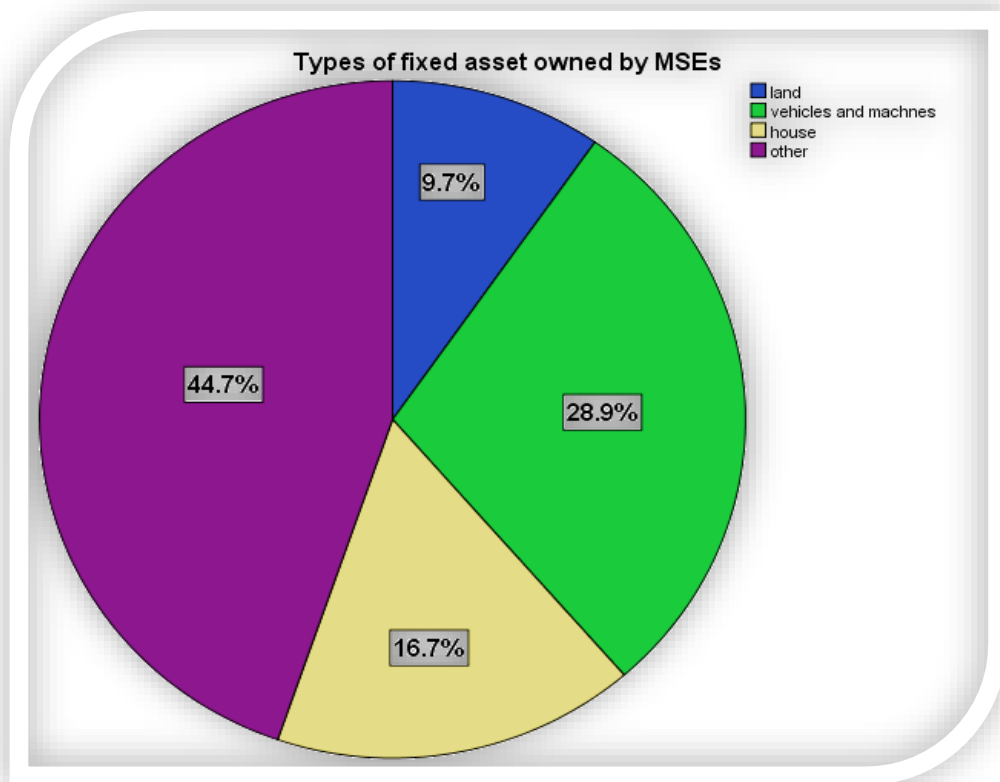


Figure 4. 6 Fixed asset possessions

Source: Own survey data computation 2020

As the above pie chart shows that regarding the type of fixed asset the operator were possessed, 9.7%, 28.9% and 16.7% have land, vehicle and machine and house respectively. The remaining 44.7% represented by other resources which are too close to the above total sum of 55.3%. This implied that most of the asset that the respondents of the operator had not serve as collateral of gaining finance to start and expand their business which further can affect their overall performance.

#### 4.4.7 Major problem of MSEs in business operation

This section discussed on the challenges of MSEs operator faces in business activity.

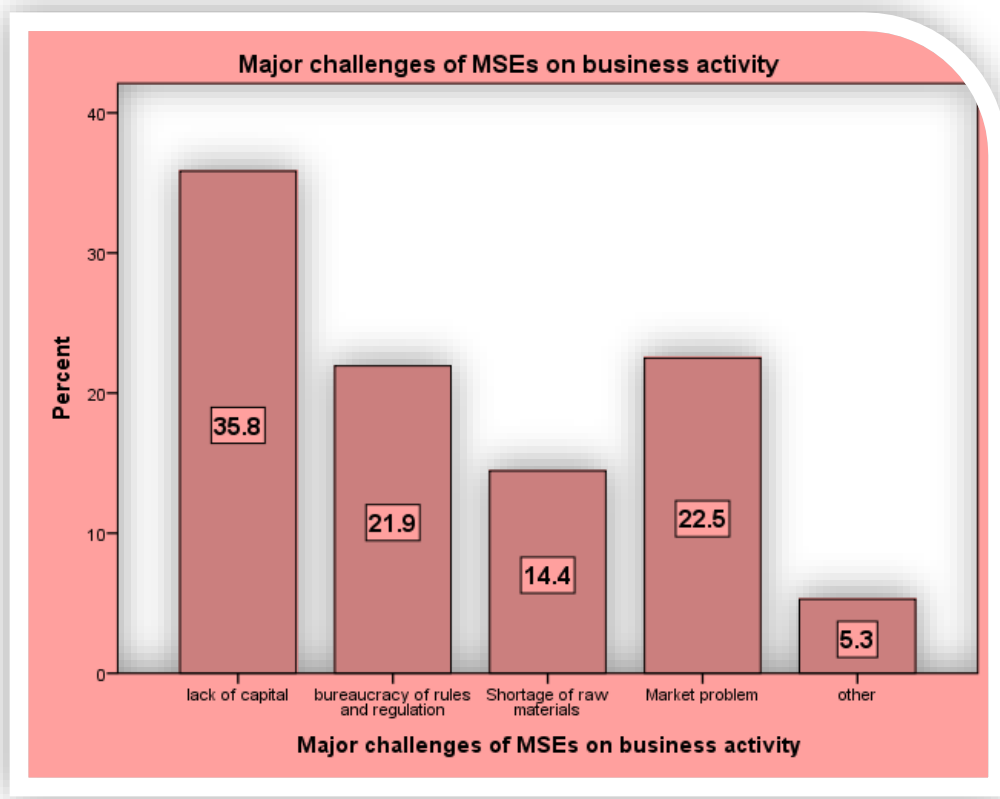


Figure 4. 7 Major problems of MSEs  
 Source: Own survey data computation 2020

Regarding to the challenge MSEs owners faces in business operation, the survey result shows that lack of sufficient capital were the most challenging factors at 35.8%.from this we can understand that most of MSEs have not sufficient capital due to start-up and expansion or working capital of

MSEs came from personal savings, micro finance institution, family and relatives, friend, iqub, legal bank, NGO, and other sources of finance respectively. This situation can be a constraint for MSEs Owner's wishing to mobilize adequate capital to begin and expand their businesses. Owners find it very difficult to access credit from banks due to lack of collaterals such as cars and/or residential houses or land titles that can be deposited to get loan from commercial banks. On the other hand, the loans provided by MFIs are small with a short Repayment period and high interest rates, this result were consistent with previous study carried by Gemechu Abdissa & Teklemariam, (2016).

The other highlighted reason for why many MSEs fail to continue trading after the initial years of set-up, People starting MSEs are generally believed to face numerous difficulties. Hence, the other challenges were government rules and regulations (21.9%), input access constraints (raw material and spare parts shortage) (14.4%), complexity of marketing process (22.5%) and the rest represented as other problems,

According to the survey result implies that the government structure of MSEs targeted office were not served as MSEs owners wishes rather its leads them frustrating and thinking blurred in to the service provided for them.

The raw materials availability were one factors of MSEs to operates their business, this implies that the owners of MSEs has not been made a market analysis and starting their business regardless of considering the availability of input and no government support regarding raw materials problem faced by them.

The other survey result implies marketing were a problems of MSEs, this is shows that the supply of product and service by MSEs were not equal to the demands, this occurs when due to lack of promotion marketing of demand and supply by concerned body through like trade exhibition and there were other factors that affect MSEs business activity like space in which to operate, and physical facilities to conduct their businesses whether this is providing a service, producing a product or trading. They require physical protection against unlawful behavior of others, but also protection in the sense of having legal mechanisms available which help to improve the conduct of businesses (example, protection against unfair competition), and incentives to prompt the start of



the business concerning the rules and regulations of the government.

## 4.5 FINANCIAL CHARACTERIZATIONS OF THE RESPONDENTS

### 4.5.1 Source of Initial startup capital

The initial sources of capital/finance/ can be raised from multiple sources. A business can use internal or external funds to finance their operations and investments based on the accessibility or availability of the alternative sources of capital. the result of analysis and discussion was indicated here under

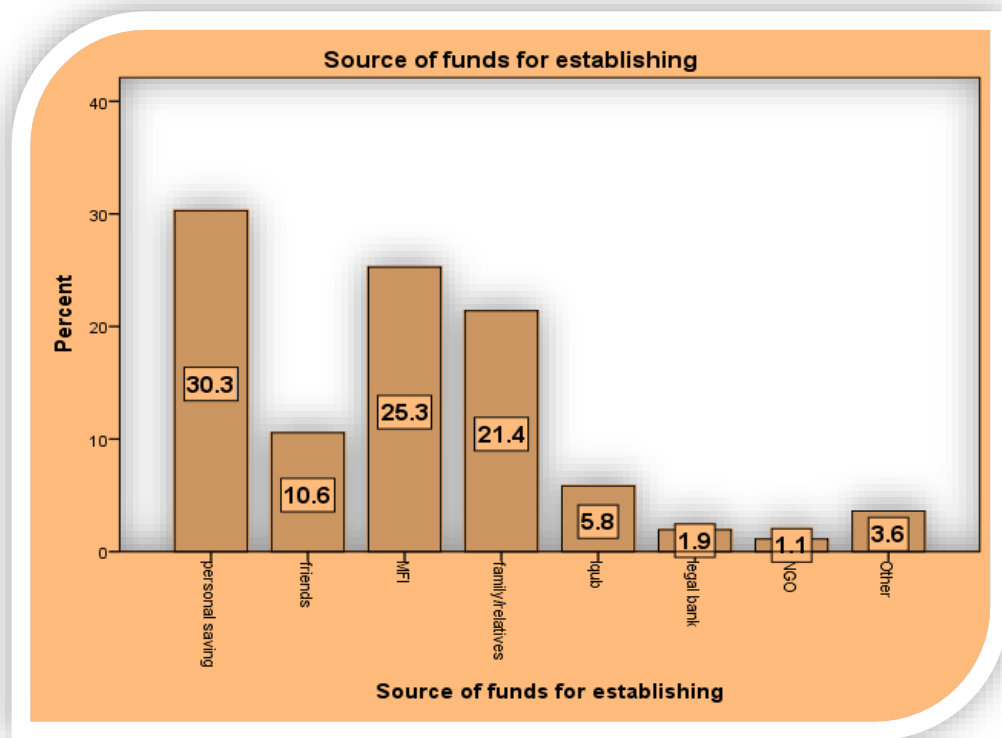


Figure 4. 8 Source of fund for establishment

Source: Own survey data computation 2020

It is also study results Microfinance and own capital/finance/ are not the only possible sources of

finance rather there are also other sources. Some MSEs have got/rose/ finance from their friends 10.6% families/relatives 21.1%, Iqub 5.8%, legal bank or formal bank (commercial banks and Ethiopian development bank) 1.9%, NGO 1.1% and other sources 3.6% respectively.

Generally, most of financial sources received by MSEs indicated above were from semi-formal and informal sources respectively, this implies that Formal sources of finance i.e., banks are refrained from providing finances to MSEs even after establishment or in due course of operation. This narrow source of finance may be the reason why businesses fail to establish and progress in the study area. This result is consistent with previous studies by (Anthony 2013; Mabhungu 2011; Odit and Gobardhun 2011) and, Ermias, 2011, Brhane Tadesse, 2011, Deresse & Zerihun 2018).

#### 4.5.2 Loan experience of sample respondents

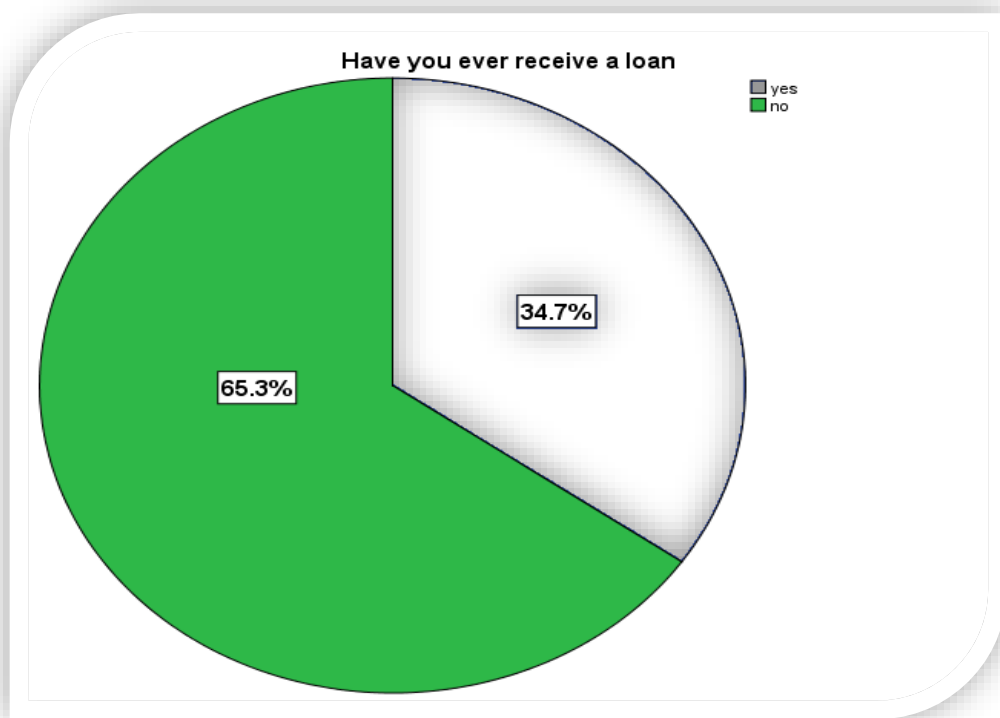


Figure 4. 9 Loan experience of MSEs  
Source: Own survey data computation 2020

The survey result shows that 65.3% of sample respondents have never received a loan from financial institution, this not implies that all these inhabitant have enough capital and they have not need to access credit but there may be numerous obstacle behind hindering them from

access to finance from financial institution, it may be due to absence of collateral, lack of information how to get, high interest rate and other reasons, whereas the remaining 34.7% have taken credit from financial institution.

### 4.5.3 Reasons for not making loan applications

In order to know the reason of MSEs owner non-loan experience, the researcher has asked respondents and the response has been presented in the following bar chart

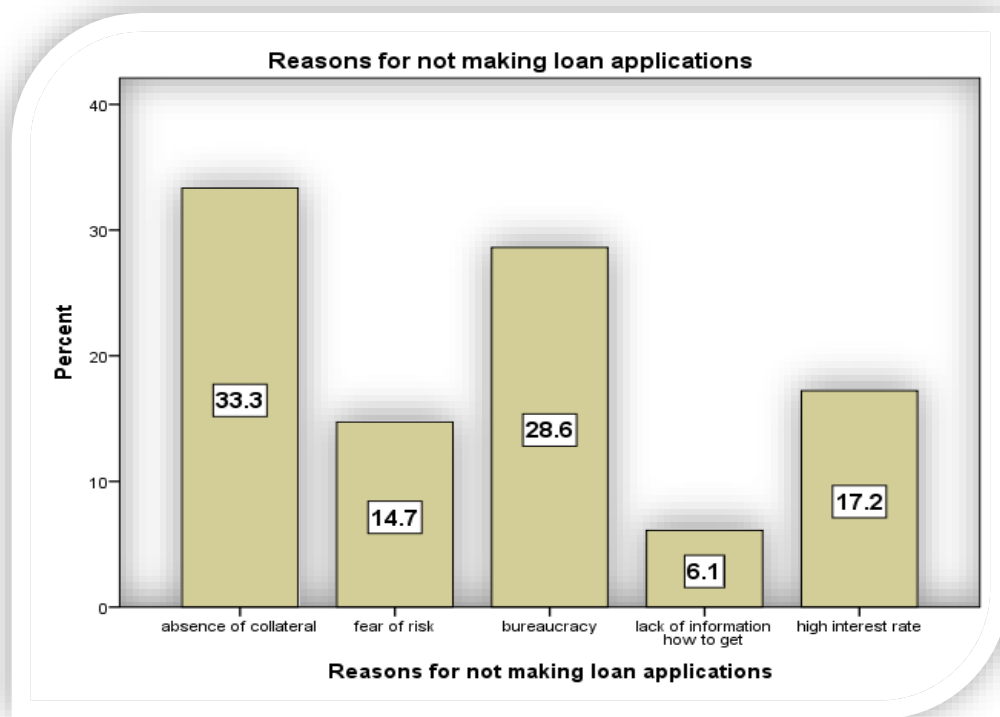


Figure 4. 10 Challenge to get loan  
Source: Own survey data computation 2020

Regarding to reason of MSEs not making loan application, the study shows that 33.3% of MSEs' operators main reason were due lack of collateral. As we seen from the above 4.4.6 finding, most of MSEs have no fixed assets like land and house. This implied that many MSEs owners have been out of access to finance due to lack of sufficient collateral. Large banks and other most financial institutions were not willing to lend money for MSEs.; because these banks and most financial institutions do not have confidence on MSEs in repaying the loan on the specified period.

In order to minimize this risk, they mostly ask collateral as pledge.

The second finding shows that 28.6% MSEs reasons not to make loan application were government rules and regulation which called bureaucracy. This implies that bureaucracy of financial institutions has been found their main financial problem. MSEs Owners have asked to complete many bureaucratic activities and should force to wait long time to get the money.

On the other hand, findings shows that 17.2% of sample respondents agreed that interest charged in to loan is a very high, due to this they were not make loan application for financial institution, and they refrain themselves from taking in to account loan is good sources of finance to mobilize their business.

Other findings shows that 14.7% respondents stated that fear of risk by MSE owners have been found as the main reason of not to making loan application. This means that some MSEs owners didn't take loan from credit providers due to fear of risk on their business. As a result, some MSEs have been looking out of the access to finance and 6.1% lack of information how to get loan, what it means is that there is lack of know-how and orientation on how to search the possible sources of finance. This result is consistent with previous studies by Ermias, 2011, and Brhane Tadesse, 2014).

#### 4.5.4 Amount of loan, Time it Takes and Ranges of Capital

In order to know the amount of loan released, time delay to receive loan and capital ranges of MSEs, the researcher has shown in the following table

Table 4. 3 Financial information of MSEs

<b>Loan amount/size released for MSEs</b>	<b>Frequency</b>	<b>Percent</b>
Sufficient	73	21.4
Insufficient	283	78.6
Total	360	100
<b>Time range to receive loan</b>		
1-2 weeks	30	8.3
3-4 weeks	61	16.9

1-2 months	91	25.3
more than two months	178	49.4
Total	360	100.0
<b>capital range of the respondent</b>		
<50000	79	21.9
50001-100000	112	31.1
100001-500000	113	31.4
500001-1500000	56	15.6
Total	360	100.0

Source: Own survey data computation 2020

As we can see from the above table, most of sample respondents which were 78.6% stated that their loan size has been found insufficient. Whereas, the remaining 21.4% of respondents agreed about the loan size they had taken was sufficient. This were indicated that the amount of money requested by borrowers is much greater than the money given /released/ to the MSEs owners whereas the loan that were issued by lender institution were not according with the interest of borrower rather it depends on rules and regulation of financial institution. Due to this, imbalance of demand and supply of loan have been occurred.

Regarding to time it takes to receive a loan, it is clearly seen from the finding table above that 49.4% this is almost half of sample respondents of MSEs owner borrowers have been waiting beyond two months, 25.3% respondents waiting to receive loan ranging from one to two month from credit providers; such as from microfinance and other possible external financial sources. Whereas, 16.9% and 8.3% of the respondents stated that they have been waited ranging from three to four week and one to two weeks respectively. this implies that the credit service of financial institution were poor in terms of response rate raised by MSEs, this hindering the owners of MSEs not to making loan application. This result is consistent with previous studies by (Ermias, 2011)

With respect to capital of MSEs Operators categorized into four groups on the basis of the definition adopted by FMSEDA or MOUDH. The result of the study showed that, 53% of the respondents were reported that they own capital of less than 100,000 ETB whereas 31.4% of the respondents reported as they have a capital of between 100,001 to 500,000 ETB. The rest of

respondents which were 15.6% of MSE have total capital of above 500,001 birr. From the finding we can understand that most MSEs were started their operations from scratch using relatively small start-up capital. on the other hand economic systems of our country were too volatile, this needs very strong capacity to survive in the market place, however the MSEs in Ethiopia were infant stage of business operation, therefore it is too difficult to make themselves adopt with this economic environment due to lack of capital.

#### 4.5.5 Finance is as a major factors of business operation

The under pie chart discussed about the perception of sample respondents about finance as a major factors of business activities.

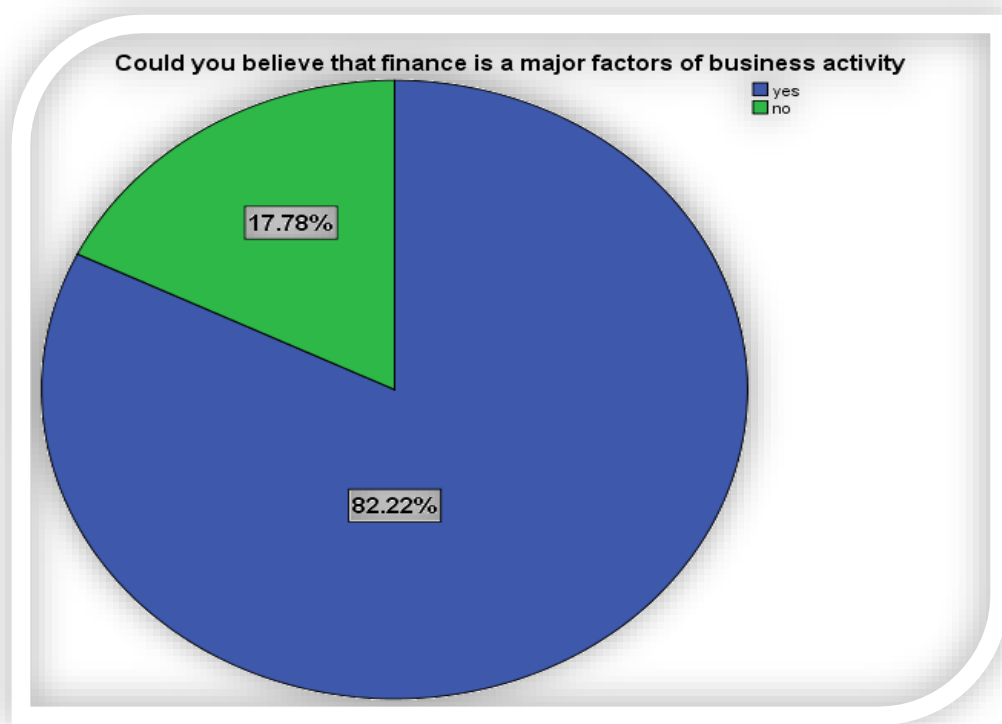


Figure 4. 11 Finance as major factors of business operation

Source: Own survey data computation 2020

Regarding to finance as a major factors of business operation, as we have seen the above pie chart 82.22% of sample respondents agreed that finance have been a major factors affecting business operation. The remaining 17.78% of MSEs operators/owners have been states as finance is not a major factor of business operation. The finding shows finance have been a significance effect on business activity is very high, the study also consistent with the previous study conducted by

Gemechu Abdissa & Teklemariam, (2016) Correlation Analysis between Financial factor and SMEs performance, and the results are there is significant correlation between financial factor and SMEs performance.

#### 4.5.6 Challenges of access to finance for MSEs

In this section, the researcher were investigated the challenges that affect MSEs to access loan from formal financial institution. In order to prioritize the challenges from highest to list factors to access to finance, the researcher has been asked respondents and the response has been presented in the following table.

Table 4. 4 Challenges of access to finance for MSEs

<b>Descriptive Statistics</b>					
	N	Minimum	Maximum	Mean	Std. Deviation
Owner's manager's Age	360	1.00	5.00	3.6139	.97793
Education	360	1.00	5.00	3.2778	1.13714
sex of the respondents	360	1.00	5.00	3.3361	1.06126
Religion	360	1.00	5.00	3.1944	1.07955
Entrepreneurship Capability	360	1.00	5.00	3.6472	.95905
Experience of the Owner/Manager	360	1.00	5.00	3.2778	1.06374
Collateral requirement	360	1.00	5.00	3.7028	.96339
Number of Employee	360	1.00	5.00	3.5444	1.00318
Legal form of Business	360	1.00	5.00	3.7778	.91448
Duration of Business Age of the Firm	360	1.00	5.00	3.7694	.90166
Size of the MSE	360	1.00	5.00	3.6417	.95988
Interest rate	360	1.00	5.00	3.8639	.90546
Credit Policy of Financial Institutions	360	1.00	5.00	3.8167	1.12691
Repayment Period	360	1.00	5.00	3.4417	.98283
Fixed Lending Costs	360	1.00	5.00	3.5250	1.05262
Valid N (list wise)	360				

**Source: Own survey data computation 2020**

According to survey result, possession of fixed asset has a large factors on MSEs access to credit from financial institutions at mean value of 3.86. This result is consistent with previous studies by (Mabhungu 2011; Odit and Gobardhun 2011) and is inversely related with (Tsehaye, 2013).

Financial institutions are mostly comfortable to provide credit when borrower can provide collateral. Collateral acts as a screening device and used to minimize a risk. In the case of default, collateral serves to put the lender into a privileged position with regard to other creditors. In this regard MSEs were disadvantaged because of that they lack collateral as a pledge. Therefore, formal financial institution providing loan to MSEs on base of collateral regardless of considering the business proposal were profitable or not (Green, 2003).

From the survey result, Interest rate is one of the challenges that MSEs faces to access credit, this factors have huge influence on MSEs followed by collateral a mean value of 3.7. this implies that interest charged by financial institution have make the owner of MSEs frustrated to access to loan. According to Anthony 2013 found out that interest rate has a negative effect on credit allocation. Higher interest rate discourages micro and small enterprises to deepen their financial access.

Regarding to lending procedure, the survey result indicates that it has a negative factors of access to credit from financial institutions with a mean of 3.81, MSEs operators who have a negative attitude about lending procedure. This implies that to get loans MSEs are expected to go through different processes and procedures, which is time-taking, cumbersome and sometimes difficult to understand. Rather they prefer to take loan from the informal credit institutions for the sake of ease even if it charges higher interest rates.

The survey result found that, firm's size has a significant effect on access to finance from financial institution at mean value of 3.64. this implies that financial institution refrain the loan serviced to MSEs due to numerous reason, according to Cassar (2004) argues that it may be relatively more costly for smaller firms to resolve information asymmetries with debt providers. Consequently, smaller firms may be offered less debt capital.

Fixed lending cost were the other challenging factors that MSEs faces to access credit, a result shows that 3.52 mean value has indicated that sample respondents stated lending cost as factors of access to loan. this implies that the loan amount released for MSEs and the corresponding cost of borrowing of money were high, this makes MSEs owners refrain themselves to access loan.

On the other hand, sectors of business also one of constraint to access credit, from the survey



found that a mean value of 3.77 represented as factors of access to finance Martin and Daniel (2013) also found that the industry with which the business belongs was also found to have an implication on access to finance.

The above table result showed that loan repayment period has a negative impact on MSEs access to credit from financial institutions at mean of 3.44. This result is consistent with previous studies by (Wenner 2000).this implies that formal financial institutions have rules and regulations that limit and fix the time at which the borrower should repay the loan, this rules and regulation is set as per financial institution strategy as well as purposes rather MSEs plan and willing to the loan. Due to this reason individuals fear taking loans from formal credit sources and are discouraged from participating in credit market (Wenner, 2000). This implies that MSEs have not strongly enough in terms of capital to settle their credit principal with in specified period adopted by lenders.

As we have seen the result from survey , firm age have factors on firm's access to credit than other challenges like age, sex,education and employment number, entrepreneur capability and experience of MSEs owner's at a mean value of 3.33. Operating period or age of the enterprise does create a difference with respect to access to credit from financial institutions.

The other factors found in the survey is experience of the manager/owners of MSEs, which was valued at mean of 3.27, this implied experiences of the owner have affect MSEs Access to finance. On the other hand, the survey result showed that capability of manger/owners of MSEs has affect access to credit from formal financial firms at mean value of 3.647.

Employment size is another factor that has an effect on MSEs access to credit from formal financial institutions at mean value of 3.54. Small firms face with information opacity such as being unable to provide financial information. When the firm is small, most of the time it is owned and operated by the entrepreneur himself and there is no such legal requirement to regularly report financial information and many firms do not maintain audited financial accounts (Storey, 1994).

Regarding to Educational level of the MSEs operators or managers has a positive factors on MSEs access to credit from formal financial institutions at mean of 3.27, educated entrepreneurs have the

ability to present positive financial information and strong business plans and they have the ability to maintain a better relationship with financial institutions compared to less educated entrepreneurs. Secondly, the educated entrepreneurs have the skills to manage the other functions of the business such as finance, marketing, human resources and these skills results to high performance of the business which helps those firms to access finance without any difficulty. The third reason stems from the supply side, where the bankers value higher education level of the owner/manager in the loan approval process as an important criterion (Irwin and Scott, 2010).

The variable entrepreneur's age has also effect on MSE's access to credit from formal financial institutions at mean of 3.6. The personal financing preferences of entrepreneurs appear to change according to age and the age of the entrepreneur is a significant determinant of the risk of borrowing. This implies that as the age of an entrepreneur increases, so does his business experience, practical, wisdom and his income generating capacity (Swain, 2001). And according to martins and Daniel 2013, the older age the credit history than younger, therefore, the lender can assess credit history that were accumulated by older age than younger and take as security to provide credit facility.

According to the survey, Religion had little effect than other challenges that may MSEs faces to access to credit from formal financial institutions at mean value of 3.1. This implies that formal financial institutions have no concern on Religion to set a difference in lending to MSEs. And the other factors that equally valued with gender factor are religion of MSEs owners a mean of 3.1.

#### **4.6 GOVERNMENT SUPPORT AREA REGARDING MSEs**

In this section we have been discussed on the support of government expected to MSEs, like training, facilitating of market, physical infrastructure, provision of incentives, MSEs target financial institution and others. In order to know such findings, the researcher has asked respondents and the response has been presented in the following table.

Table 4. 5 Government support regarding to MSEs

Items	Frequency	Percent
-------	-----------	---------

<b>Training before start up business</b>		
Yes	142	39.44
No	218	60.56
Total	360	100.00
<b>Training after start up business</b>		
Yes	110	30.56
No	250	69.44
Total	360	100.00
<b>Interconnection of MSEs with financial institution</b>		
Yes	79	21.94
No	281	78.06
Total	360	100.00
<b>Pushing of formal financial institution to relax collateral requirement</b>		
Yes	71	19.72
No	289	80.28
Total	360	100.00
<b>encourage establishment of MSEs targeted financial institution</b>		
Yes	203	56.39
No	157	43.61
Total	360	100.00
<b>Information on access to finance from the government</b>		
Enough	83	23.06
not enough	277	76.94
Total	360	100.00
<b>Provision of some incentives to MSEs</b>		
Yes	47	13.06
No	313	86.94
Total	360	100.00
<b>Facilitate the complex process of marketing problem</b>		
Yes	108	30.00
No	252	70.00
Total	360	100.00
<b>Physical infrastructures</b>		
Yes	122	33.89
No	238	66.11
Total	360	100.00
<b>Government support regarding micro and small enterprise</b>		
Enough	56	15.56

not enough	304	84.44
Total	360	100.00

Source: Own survey data computation 2020

Regarding to training that provide for MSEs before and after start up business , the survey result shows that 60.56% of sample respondents stated that they have not taken any training before startup and the remaining 39.44 has taken training and also after startup business 69.44% represented has not taken training and the rest 30.56% have taken training. This implies that most of MSEs owner were started their business without businesses environment by taking Training, according to Gebrehiwot and Wolday training applies to any transfer of knowledge, skills or an attitude which is organized to prepare people for more productive activities, or to change their working environment. Unlike formal educational programs, short-term skill training, directly or indirectly affects the performance of MSE operators.

The survey result shows, 21.94% of sample respondents were answered the government does trying to connect and announce financial institution with MSEs, whereas 78.06% of respondents stated that any interconnection promotion between formal financial institution with MSEs does not used by the government.

With regard to the government activity in line with pushing formal financial institution relax their collateral requirement, the survey result shows that 80.28% were stated that government do nothing to push them in order to relax their stiff collateral requirement whereas 19.72% answered in reverse. However, According to (FMSEDA, 1997) The stiff and limited nature of collateral requirements that are currently being requested by the formal financial institutions should be relaxed in order to create more access to small borrowers.

The above table shows that 56.39 sample respondents agreed that have involving to expanding MSEs target financial institution whereas the remaining have not satisfied with this idea. Although, according to (FMSEDA, 1997) In this regard, a micro-financing proclamation has been promulgated, which specifically caters for the financial requirements of MSEs. There are also some ongoing programs that witness encouraging developments in the area of micro financing.

These include the Relief Society of Tigray (REST) in Tigray, the Ethiopian Relief Organization (ERO) in Amhara, the Ethiopian Social Rehabilitation and Development Fund (ESRDF) and other NGOs that have already included in their activities the financing of MSEs both in rural and urban areas. Therefore, Government will further encourage and create the enabling ground for the establishment of such MSEs targeted financial institutions.

Regarding to information on access to finance, 76.94 sample respondents have not get enough information, whereas the remaining 23.06% have enough information on how to get loan, and on provision of some incentive to MSEs in order to minimize their business burden 86.94 sample respondents have stated that they didn't whether there is an incentive or not whereas the remaining 13.06% have an idea of provision of incentive from the government. And regarding with easing complex process of marketing problem, 70% were resisting and the remaining 30% were accepted that the government involvement of facilitating the complex process of marketing problem. On the other hand, the survey result indicated that 66.11% of respondents were not satisfied with the government involvement in to physical infrastructure and the remaining 33.89% have been satisfied.

Lastly regarding to government support on MSEs, the survey shows that 84.44% of sample respondents were not satisfied with the government involvement to support MSEs in order to maintaining them in favorable environment, whereas the remaining respondents stated that the progress of government to support MSEs were promising.

## 4.7 RELATIONAL DATA (CROSS TABULATION)

### 4.7.2 Business sectors and duration of the business cross tabulations

Table 4. 6 Cross tabulation of business sector with duration of business

Line of Business * Number of years in Business Cross tabulation`						
		Number of years in Business				Total
		less than 2 years	3-5 years	6-8 years	more than 8 years	
Line	of Manufacturing	15	27	18	8	68

Business		22.1%	39.7%	26.5%	11.8%	100.0%
	Trade	31	31	36	18	116
		26.7%	26.7%	31.0%	15.5%	100.0%
Urban farming	11	17	10	13	51	
	21.6%	33.3%	19.6%	25.5%	100.0%	
Construction	12	10	8	4	34	
	35.3%	29.4%	23.5%	11.8%	100.0%	
Service	24	25	22	20	91	
	26.4%	27.5%	24.2%	22.0%	100.0%	
Total	93	110	94	63	360	
	25.8%	30.6%	26.1%	17.5%	100.0%	

Source: Own survey data computation 2020

The survey result of cross tabulation revealed that in regarding with the relationship between business sector and operating years in businesses, 15% of trade sectors engaged in businesses for more than six years which is largest proportion of all business sectors, and followed by service, manufacturing, urban and construction sectors at 11%, 7%, 6% and 3% respectively.

The survey also revealed that more than 55% from all sector sample respondents operates in businesses have staying for less than five years, which indicates that most of MSEs were at infant stage, this also implied that they needed support in all dimension in order to keep them safe.

#### 4.7.3 Cross tabulation between Business sectors and capital range of MSEs owners

Table 4. 7 Cross tabulation of business sector with capital range

Line of Business * capital range of the respondent Cross tabulation						
		capital range of the respondent				Total
		<50000	50001-100000	100001-500000	500001-1500000	
Line of	manufacturing	3	19	28	18	68

Business		4.4%	27.9%	41.2%	26.5%	100.0%
	Trade	34	37	29	16	116
		29.3%	31.9%	25.0%	13.8%	100.0%
Urban farming		13	12	15	11	51
		25.5%	23.5%	29.4%	21.6%	100.0%
construction		1	5	21	7	34
		2.9%	14.7%	61.8%	20.6%	100.0%
service		28	39	20	4	91
		30.8%	42.9%	22.0%	4.4%	100.0%
Total		79	112	113	56	360
		21.9%	31.1%	31.4%	15.6%	100.0%

Source: Own survey data computation 2020

Regarding to relationship between sector of businesses and capital ranges of MSEs, the survey shows that, 53% of MSEs owners are running their businesses with a capital of less than 100000 ETB, at this time due to economic volatility the cost of everything which is needed by MSEs were rapidly increasing but their capital were remaining constant, this leads MSEs make them out of market and owners have were not make them free to operate their business in order to upgrade their business in terms of expansion, new enterprise, purchase of machine and hiring of more employees , the remaining 47% of sample respondents have a capital of more than 100000 ETB.

In addition to this the survey result shows that 12.7%, 12.5%, 7%, 8% and 6% is a capital range more than 100000 ETB occupied by under sector of manufacturing, trade, urban farming, construction, and service respectively, from this we can see that manufacturing sectors used more capitals than other sectors, this mean not that they have enough capital to running their business as we have seen from the survey result of 4.5.4, more than 68% sample respondents stated that their capital to running their businesses is not sufficient.

#### 4.7.4 Cross tabulation between legal form of Business enterprise and working premise of business enterprise

Table 4. 8 cross tabulation of legal form of business with working premise

legal form of business enterprise * working premise of business enterprise Cross tabulation						
		working premise of business enterprise				Total
		Family	Government	Rented	other	
legal form of business enterprise	sole proprietorship	77	11	125	26	239
		32.2%	4.6%	52.3%	10.9%	100.0%
	Partnership	18	60	33	10	121
		14.9%	49.6%	27.3%	8.3%	100.0%
Total		95	71	158	36	360
		26.4%	19.7%	43.9%	10.0%	100.0%

Source: Own survey data computation 2020

With regarding to relationship between legal form businesses and working premises, according to the survey result shows approximately 34.7%, 21%, 7% and 3% of sample respondent of sole proprietorship started their businesses by rent, family, other working premise and government building respectively, in addition to this the survey result shows that 16.6%, 9%, 7% and 5% of sample respondents of partnership starting their businesses by government, rent, other working premise and family buildings respectively.

According to the survey result, most of MSEs used working premise by rent building than any other method of working premises, in addition to this sole proprietor were largest legal form of businesses by using rent building than partnership and the findings shows that partnership legal form of businesses were more accessible than sole proprietorship to get premises from the



government side, this also implies that government give little attention to business enterprises that are formulated by single owners.

## **CHAPTER FIVE**

### **5 SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 SUMMARY OF FINDINGS**

This study was guided by the main objective of investigating the source and challenges of finance for MSEs in Jimma town. According to the finding incorporated in the previous chapters discussion and analysis of the presented data, the following findings are drawn and summarized as below

- Regarding to demography of respondents, more than 90% of MSEs operators/owners age fall below 45 years and the remaining 10% fall above 45 years old, this indicates that most part of MSEs owners are adults. Indicated in then educational status of MSEs operators indicates that more than 70% had no formal education to diploma and about 24% were degree holders and above. Regarding then sex composed of sample respondents, more than 70% were male and the remaining were females.
  
- Regarding to general business information the survey result shows, from the total sample respondents 32.2%, 25.3%, 9.4%, 14.2% and 18.9% were engaged in trade, service, construction, urban farming and manufacturing sectors respectively. In line with the number of staff employed in MSEs. The findings have shown more than 50% of sample respondents were less than 5 employees the remaining to 6-10, 11-15, 16-20 and more than 21 employees respectively. The work experience of MSEs in business, more than 50% of sample respondents have less than five years which is infant stage, and this implies most partners of MSEs were younger. In addition to this the legal form of businesses, showed that 66.4% and 33.6% are sole proprietor ship and partnership respectively. Motivation to getting in to business of MSEs owners, findings showed that 28.1%, 19.4%, 32.5% and 20% were entrepreneurial experience, skill of owners, family/relative advice and by having no alternatives respectively. Result of working premise of owner's shows most of MSEs operators start their business by renting buildings and the rest in then residence, government owned shelters and prefabrles. Fixed asset possession of MSEs

reported were found as 9.7%, 28.9%, 16.7% and 44.7% land, vehicle/machine, and house and other respectively. Lastly the survey shows that the major problem of MSEs, stated that 35.8%, 21.9%, 14.4%, 22.5% and 5.3% of sample respondent's response represented lack of capital, government bureaucracy rules and regulation, shortage of input materials, marketing problems and other respectively.

- Regarding to financial characteristics of the respondents, the results of the survey shows that, most of MSEs initial sources of fund for establishment were personal saving and MFIs, on the other hand the credit experience of MSEs were less than 50%, in addition to this the loan amount received by MSEs as stated by more than 75% of sample respondents insufficient. And also the time it takes to receive credit is very long, about 50% sample respondents received their loan after two months, on top of this credit amount received by respondents were very small. About 52% of sample respondents receive less than 100000 ETB, and also this survey result shows the obstacle of access to finance, this indicates that the major challenges faced by MSEs is to get loan which in linked to absence of collateral followed by high interest rate and bureaucratic rules and regulation of credit policy of financial institution and lastly most respondents agreed that financial source as a major factors of business operation.
- With regard to government support to MSEs, the survey result shows that the training availability for MSEs before and after startup businesses about 35% which is very small figures relative to expectation from the government body, in addition to this the study shows that pushing of MFI to relax their collateral requirement to reducing the credit difficulties to MSEs were very small about 20% of the sample respondents agreed with this, and also the study shows that information available to MSEs about how to get loan were still very small about 24%, and the other findings shows that the provision of incentive to MSEs, facilitating of complex marketing problem, developments of physical infrastructure, encouragement of MSEs targeted financial institution and generally the overall support of government to MSEs owner in order to facilitate their business and to reduce burden were too low.

## 5.2 CONCLUSIONS

The primary objective of the national strategy framework was to create an enabling environment for MSEs. to further ensure the proper institutional coordination for MSEs support function the government created federal as well as regional Micro and Small Enterprises Development Agencies. Despite their huge contribution to the national economy in most developing countries, Ethiopia alike, MSEs face a wide range of challenges and they are often unable to address the problems they faced on their own. According to the survey results the researcher concluded that:-

- ❖ In view of the above findings, the study concludes that the major source of startup finance and also working Capital is personal savings and OCSSCO (micro finance institutions) of Jimma branch which can also determine as informal and semiformal financial institutions, another important issue to note is that personal saving and MFIs are more engaged with financing SMEs than banks. Out of those who had access to finance from formal institutions, more than 55% had their access from personal saving and MFIs. Only close to 1.9% had their finance from banks.
- ❖ Access to finance is one of the key issues of MSEs not only when starting the business project but also when operating. Identifying the major challenges of access to finance is therefore quite crucial, therefore, the results indicate that major MSEs challenges they faced while accessing for finance is stiff collateral requirement, interest rate and credit policy of financial institution were at a descending order and other challenges have less factors like size of MSEs, Sector of business, repayment period of loan, duration of business, Owners experience, entrepreneurship capability, number of employees, educational status, manager's age, sex of manager's and owner's religion at descending order respectively.
- ❖ Regarding to support expected from government for MSEs in order to mobilize their activities, the findings conclude that government motive to encourage establishment of MSEs targeted financial institution in order to meet budget deficits of MSEs were appreciated and growing, whereas the other support expected from the government like delivery of training, development of

infrastructure, resolution of marketing problem, provision of incentive to share MSEs burden of cost to motivate, Pushing of formal financial institution to relax collateral requirement, Interconnection of MSEs with financial institution and Information on access to finance from the government were not encouraging and satisfactory.

### **5.3 RECOMMENDATION**

After a detailed investigation has made on the research title of source and challenges to finance for MSEs, the researcher forwards the following suggestions for constructive policy promotion that will be undertaken by all concerned stakeholders

- Stiff requirement of collateral, boring Bureaucracy, rules and regulation of credit policy of financial institution, and high interest rate were the main determinant factors of MSEs hindering owners from taking loans and financing on operations from financial institution, thus it is quite important to seek alternative means of solution to guarantees for collateral requirements such as municipality as a guarantee and resolution of bureaucratic confusion through discussion with concerned bodies and by reduction of interest charge in order to motivate MSEs to take credit as an important source of finance, in addition to this it is not the only challenges that MSEs faces to access credit.
- Regarding, delivering of training service as government support to MSEs owners were very crucial in order to build capability, skills and experiences to mobilize their business operation appropriately, Although the regional MSEs development agencies trying to deliver training to MSEs owners, but still it is not covered at least more than half total MSEs operators, hence the government should incorporating with concerned bodies and give more attention on the issue of human capacity development in order keep and develop efficiency and effectiveness's of the existing and new comer operators on this field, in addition to this government supports in different dimension to smoothening of operation of MSEs were limited like infrastructure development, provision of incentive, facilitating of complex marketing, and others, hence it is expected from the government bodies to assess the gap and fill appropriately. While developing strategic framework for MSEs federal and regional states disclosed in then their objective statement about the involvement of female as an unquestionable agenda, even though the mission statement said this, the proportion of gender were very different, more than two third of MSEs operators were male,

this implies that it is homework for government, therefore government should give more attention to design additional female support strategy to encourage the participation.

- Most of our MSEs faced of capital insufficiency and time it take to receive, more than 50% of MSEs run their business with a capital of less than 100000 ETB and more than 75% of sample respondents receive loan one month after then application, this lead them to numerous disadvantage, therefore MSEs targeted financial institution and concerned bodies are expected to deal with this issue and give more attention in order to alleviate the service provided and amending of loan amount they released to MSEs.

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**APPENDIX**  
**JIMMA UNIVERSITY**  
**COLLEGE OF BUSINESS AND ECONOMICS**  
**MSC PROGRAM**

The purpose of this questionnaire is to collect information on a study on sources and challenges of finance for micro and small enterprises in case of Micro and Small Enterprises in Jimma Town. The study is only for academic purpose and cannot affect you in any case. So, your genuine, honest and timely response is vital for accomplishment of this study on time. Therefore, I kindly ask you to give your response to each items/questions carefully.

❖ **GENERAL INSTRUCTIONS:**

- ✚ Your participation is voluntary.
- ✚ I guarantee you that your responses will not influence your present and future employment with the enterprise.
- ✚ Writing your and enterprise's name is not necessary.
- ✚ Please tick on your appropriate response

❖ **PART ONE: PROFILE OF PARTICIPANTS**

1. Sex

- Male       Female

2. Age:

- 15-25       26-35
- 36-45       46-55       more than 55

3. Educational Qualification

- No formal education     Primary       Secondary

TVET                       Diploma       Degree

Masters and above

4. Marital Status

Married                       Divorced

Single                       Other

❖ **PART TWO: BUSINESS INFORMATION'S**

5. In which developmental sector of MSE did you engaged?

Manufacturing       Trade                       Agricultures

Construction               Services

6. How long did you do this activities (durations of the business?)

Less than 2 year               3-5 year

6-8 year                       More than 8 years

7. What is the legal form of your business?

Sole proprietorship               cooperatives

Partnership                       other

8. What is your reason for getting into this business?

Skill  apparent ship practices

Parent/relatives  I had no alternatives

9. How is the working premise of your business held up?

Family  Government

Rented  other

10. What type of fixed Asset you have?

Land  vehicles or machine

House  other

11. What do you think the major problem of your business?

Lack of capital  bureaucracy of rules & regulation

Shortage of raw materials  Market problem

Other

❖ **PART THREE FINANCIAL INFORMATION'S**

12. From where did you get initial startup capital?

Personal saving     Friends     MFI

Family/Relatives     Iqub     legal bank

NGO     other

13. Have you ever received a loan?

Yes     No

14. What is a challenge face MSEs to receive a loan?

Absence of Collateral     fear of risk

Bureaucracy     lack of information how to get

High interest rate

15. Do you have adequate capital for your business?

Yes     No

16. Could you please specify the range of your capital in Ethiopian Birr?

Below 50,000 Birr     50,001-100,000 Birr

100,001-500,000 Birr     500,001-1,500,000 Birr

Above 1,500,000 Birr



17. The loan amount/size released for MSEs are

- Sufficient                       insufficient

18. How long it take to you to receive the loan?

- One to two week                       Three to four week

- One month to two month                       More than two month

19. Could you believe that finance is a major factor of your business performance?

- Yes                       No

20. From the following factors which influence you not to access credit facility?

Element	No Extent	Small Extent	Moderate Extent	Great Extent	Very great Extent
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	(1)	(2)	(3)	(4)	(5)
<b>Entrepreneur Characteristics</b>					
Owner's manager's Age					
Education					
Sex					
Religion					
Entrepreneurship Capability					
Experience of the Owner/Manager					
<b>Firm Characteristics</b>					
Collateral requirement					
Number of Employee					
Legal form of Business					
Duration of Business Age of the Firm					
Size of the MSE					
<b>Institutional/credit term Characteristics</b>					
Interest rate					
Credit Policy of Financial Institutions					
Repayment Period					
Fixed Lending Costs					

❖ **PART THREE INFORMATION REGARDING GOVERNMENT**

21. Did you take any training before start up business?

Yes       No

22. Did you take any training after starting up business?

Yes       No

23. Is Government committed to strengthen the link between micro and small enterprises and existing as well as evolving financial institutions?

Yes       No

24. Is the government pushes formal financial institutions to relax their stiff and limited nature of collateral requirements in order to create more access to small borrowers?

Yes       No

25. Is the Government encourage and create the enabling ground for the establishment of MSEs targeted financial institutions?

Yes       No

26. Information on Access to Finance from the government is

Enough       Not enough

27. Do you have an idea about the provision of incentives for MSEs in order to minimize their business burden?

Yes       No

28. Is government undertaken responsibility to facilitate the complex process of marketing problems of MSEs in order to ease challenges?

Yes       No

29. Do you satisfied with Physical Infrastructure which is developed by the government in

order to facilitate business of MSEs?

Yes       No

30. Generally government support regarding micro and small enterprise?

Enough       Not enough

**THANK YOU!!**