



INDIRA GANDHI NATIONAL OPEN UNIVERSITY
School of Management Studies

**A Thesis on Factors Affecting the Performance of Micro and Small
Enterprises in kirkos Sub- city, Addis Ababa, Ethiopia**

**Project work submitted to the Indira Gandhi National Open University in
partial fulfillment of the requirements for award of Degree-Master of
Business Administration (Finance).**

By: Mehari W/Aregay

May, 2016

**Addis Ababa
Ethiopia**

Declaration

I undersigned declared that this thesis is my original work and has not been presented for a degree in any other university, and that all sources of materials used for the thesis have been duly acknowledged.

Name:- _____

Signature:- _____

Date:- _____

CERTIFICATE OF ORIGINALITY

This is to certify that the project titled “**Factors Affecting the Performance of Micro and Small Enterprises in kirkos Sub- city, Addis Ababa, Ethiopia**” is an original work of the Student and is being submitted in partial fulfillment for the award of the Master’s Degree in Business Administration of Indira Gandhi National Open University. This report has not been submitted earlier either to this University or to any other University/Institution for the fulfillment of the requirement of a course of study.

SIGNATURE OF SUPERVIOR

Place: Addis Ababa, Ethiopia

Date: May 2016

SIGNATURE OF STUDENT

Place: Addis Ababa, Ethiopia

Date: May 2016

Acknowledgements

It is the grace, mercy, charity, forgiveness, help and kindness of the almighty God- Jesus Christ that made me still alive, achieve this success and strength and to go through all the difficult time.

While there are several people who have helped me in one way or another to achieve the completion of this thesis, it would have not been possible without the guidance, support and expertise of my thesis advisor DEREJE GELANA. So, I would like to begin by thanking DEREJE GELANA for his constructive comments and outstanding help with this thesis, for allowing me the complete freedom to pursue this study, to work on my own initiative and for making me to use the potential that I have with confidence on my ability.

TABLE OF CONTENT	Page
DECLARATION	I
CERTIFICATE OF ORIGINALITY	II
ACKNOWLEDGEMENTS	III
TABLE OF CONTENTS	IV
LIST OF TABLES	VI
LIST OF ACRONYMS	VII
ABSTRACT	VIII
CHAPTER ONE: INTRODUCTION-----	1
1.1 Background of the Study -----	1
1.2. Statement of the Problem-----	4
1.3. Research Question-----	5
1.4. Objectives of the Study-----	5
1.4.1 General Objective-----	6
1.4.2. Specific Objectives -----	6
1.5. Significance of the study -----	6
1.6. Limitation of the study -----	6
1.7. Scope of the study -----	7
1.8. Organization of the study -----	7
CHAPTER TWO: LITERATURE REVIEW -----	8
2.1 Introduction-----	8
2.2. Definition of MSEs-----	9
2.3 The Role of MSEs in Poverty Reduction-----	12
2.3.1 Micro and small enterprise for economic Growth Arguments	13
2.4. Factors that Affect Small Scale Enterprise	14
2.4.1 Internal Factors.....	14
2.4.2 External Causes of MSEs	16
2.5 The Micro and small Enterprise in Ethiopia-----	18
2.6 The Concept of Business performance-----	20

2.7 Review of Empirical Studies-----	21
CHAPTER THREE: RESEARCH METHODOLOGIES -----	25
3.1. Research Design -----	25
3.2. Data Collection -----	25
3.3. Sampling Strategy and Procedures -----	26
3.3.1. Population -----	26
3.3.2. Sample Size and Sampling Technique -----	26
3.4. Data Analysis Technique -----	27
3.5. The Conceptual Framework-----	27
CHAPTER FOUR: PRESENTATION AND ANALYSIS OF DATA-----	29
4.1 Socio Economic Characteristics of Respondents -----	29
4.2 Factors Affecting the Performance of Micro and Small Enterprises-----	31
4.2.1 Source of Funds to Start-up and expansion-----	31
4.2.2 Access to Support Services-----	32
4.2.2.1 Access to Loan-----	32
4.2.2.2 Access to Work Premises-----	33
4.2.2.3 Access to Marketing-----	34
4.3 Financial Management Practice and MSE Performance-----	35
4.3.1 Record Keeping Practice-----	36
4.3.2 Bank Accounts-----	37
CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS -----	38
5.1 Conclusion -----	38
5.2 Recommendations -----	39
REFERENCE-----	40
APPENDICES	43
Questionnaire for Primary Data Collection	43

List of Tables	Page
Table 2.1 European Union MSE Definition-----	9
Table 2.2 World Bank Group MSE Definition-----	10
Table 2.3 Indian MSME definition According MSME act 2006-----	10
Table 2.4 Revised definition of MSEs in Ethiopia-----	11
Table 4-1 Description of Age vs. Sex of Respondents	29
Table 4-2 marital status vs. education level of respondents	30
Table 4.3 description of type of business engagement of MSEs	31
Table 4.4 description of source of fund	31
Table 4.5 description of areas of support for MSE	32
Table 4.6 Analysis of credit access to MSEs	33
Table 4.7 description of access to premises received	34
Table 4.8 description of market access	35
Table 4.9 Analysis of record keeping practice	36
Table 4.10 Possession of bank account by MSEs	37

List of Acronyms

ADL	Agriculture Led Development Industrialization
CSA	Central Statistics Agency
ETB	Ethiopian Birr
FMSEDA	Federal Micro and small Enterprise Development Agency
GDP	Gross Domestic Product
GEDRE	Government of Democratic Republic of Ethiopia
GEM	Global Entrepreneurship Monitor
GTP	Growth and Transformation Plan
ILO	International Labor Organization
LDCs	less Developed Countries
Les	Large Enterprises
MC	Management committee
MOT	Ministry of Trade
MTIO	Ministry of Trade and Industry
MSEs	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprise
PRSs	Poverty Reduction Strategies
R&D	Research & Development
SMEDP	Small and Medium Enterprise Development Policy
TRA	Tanzania Revenue Authority
UNIDO	United Nations Industrial Development Organization
USA	United State of America

Abstract

The objective of the study is to assess the factors that are mostly affecting the performance of MSEs in Kirkos sub-city of Addis Ababa by using Descriptive research methodologies. The result of the study revealed that access to loan, access work premises, access to marketing and financial management practice particularly record keeping and maintain bank accounts are significant factors of MSEs growth. Mostly the sources of start-up capital of MSEs are from personal savings, Equb/Idir and family. On the other hand MSEs have no significant access to bank loan plus banks do not provide loan to MSE's due to collateral obligations and other requirements. Evidentially 78% of MSEs have not received any credit service in the sub city. More over The MSEs are not getting the required land because of lack of awareness from the officials' side and scarcity of the land in their sub city; as a result around 28% of those MSEs have received land for their operations. the study also, shows Lack of adequate marketing channels and marketing skills, Effective financial management practices are crucial problems to the growth of MSEs as a result the researcher unable to measure the financial performance of them. Based on this finding the researcher recommended that Government officials and other stakeholders should give priority to provide land for MSEs, Accesses loan facilities, follow up for bringing changes to the lives of many MSEs, and then MSEs themselves should be aware on preparing proper financial records and practices in order to know their status.

Key words: Micro and Small Enterprises, performance, Kirkos Sub- city

CHAPTER ONE: INTRODUCTION

1.1. Background of the Study

In overall economic development, a critically important role is played by micro and small enterprises in the developing world. The vast majority of countries rely on the dynamism, resourcefulness and risk-taking of private enterprises to which most micro and small enterprises belong to sustain the process and form the base for private sector led economic growth. Expansion and development of the sector increases agricultural productivity through providing agricultural inputs and creating demand for agricultural outputs. Thus, micro and small enterprises play a key role in stimulating other sectors of the economy such as trade, construction, services and agriculture as well as in reducing unemployment (ILO, 2006).

The contribution of MSEs is more than double that of the large manufacturing sector, which stands at 7% of the GDP (Republic of Kenya, 2006). Overall, MSEs create 75% of all new jobs. Estimates show that, in the year 2005, the SME sector employed about 5,086,400 people, up from 4624400 in 2003 (Migiro, & Wallis 2006). This was an increase of 462,000 persons and consisted of 74.2% of total national employment. The average income of enterprises surveyed was about \$6,000 per month, or more than two times 100 higher than the minimum legal monthly wage for unskilled employees, which in 2006 was \$2,536. The share of the MSE sector's contribution to GDP was estimated at 18.4 percent. It is recognized that MSEs constitute a significant portion of the Kenyan private sector. They participate in overall investment, in production of goods and services, in taking risks, in perceiving and utilizing new economic opportunities and in developing business in the economy. In Kenya, MSEs have contributed to the extension of price-based signals into areas such as urban service delivery; garbage collection, urban transport, water distribution and manufacturing of a wide range of domestic and commercial appliances (ILO, 2002).

The micro and small business sector is recognized as integral component of economic development and a crucial element in the effort to lift countries out of poverty (Wolfenson, 2007:28-39). The dynamic role of micro and small enterprises (MSEs) in development countries as engines through which the growth objectives of developing countries can be achieved has been recognized. It is estimated that MSEs employ 22% of the adult population in developing countries (Fisseha. 2006:43).

In developing countries, 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. The MSEs Sector has also been instrumental in bringing about transition by providing goods and services, which are of adequate quality and are reasonably priced, to a large number of people, and by effectively using the skills and talents of a large number of people without requiring high-level training, large sums of capital or sophisticated technology (ILO, 2008:56). Similarly, Lara and Simeon (2009:1453-1464) found that the MSE sector generate substantial employment and economic output in many countries. Their share of overall employment tends to be higher in developing countries, which are typically more focused on small-scale production.

The sector has potential to provide ideal Environment for enabling entrepreneurs to optimal exercise their talents and to attain their personal and professional goals (MoTI, 1997:9). In all successful economies, MSEs are seen as an essential springboard for growth, job creation and social progress. The small business sector is also seen as an important force to generate employment and more equitable income distribution, activate competition, exploit niche markets, and enhance productivity and technical change and, through the combination of all of these measures, to stimulate economic development. This is not denying the importance of large industries and other enterprises for the growth of the Ethiopian economy, there is ample evidence to suggest that the labor absorptive capacity of the MSE sector is high. The average capital cost per job created is usually lower than in big business, and its role in technical and other innovative is vital for many of the challenges facing Ethiopia (MoTI, 1997:9).

In Ethiopia, MSEs sector is the second largest employment-generating sector following agriculture (CSA, 2005:34-35) .A national survey conducted by Ethiopian central statistical authority (CSA) in 2005 in 48 major towns indicates that nearly 585,000 and 3,000 operators engaged in micro and small scale manufacturing industries respectively, which absorb about 740,000 labor forces. Accordingly, the whole labor force engaged in the micro enterprises and small scale manufacturing industries is more than eight folds (740,000 persons) to that of the medium and large scale manufacturing industries (90,000 persons). This is a contribution of 3.4% to GDP, 33% of the industries sector's contribution and 52% of the manufacturing sector's contribution to GDP of the year 2001(CSA, 2005:34-35).

According to Mulhern (1995:2-92), MSEs exert a strong influence on the economies of all countries, particularly in the developing countries. He reported that the MSEs have been a major engine in the economic growth, innovation and technological progress. In addition carrier (2008: 11-23) stated that:

”The MSEs are more fertile than their larger (enterprises) in terms of innovation and development. The MSE sector is characterized by highly diversified activities which can create job opportunities for a substantial segment of the population. This indicates that the sector is a quick remedy for unemployment problem. To curb unemployment and facilitate the environment for new job seeker and self-employment a direct intervention and support of the government is crucial.”

Assistance and support to strengthen these enterprises can lead to higher profits and employment levels which in turn can contribute to a bottom-up transition out of poverty for entrepreneurs and workers (Sievers & Vandenberg, 2007:1341).

Furthermore, according to Mead & Liedholm (2009), the MSE activities can contribute to increasing tax-incomes for the Government and enable the government in the long run to invest the money. In order to strengthen the position of MSEs, the access to financial and non-Financial services plays a pivotal role in the performance and expansion of these enterprises. The strengthening and the expansion of existing MSEs and the support of new enterprises can contribute to fulfill social objectives, attract considerable foreign reserves into a country and have a clear importance in providing employment, meaning they are the backbone of the private sectors in developing countries.

The aim of MSE development and the provision of MSE services are to enable the entrepreneurs to take advantage of market opportunities and improve the access to skill development opportunities that strengthen entrepreneurial capabilities (UNIDO, 2002:36).

Micro and small enterprise in Ethiopia are, however, confronted with several factors that affect the performance of MSE. The major factors include financial problems, lack of qualified employees; lack of proper financial records, marketing problems and lack of work premises, etc. besides, environmental factors affects the business which includes social, economic, cultural, political, legal and technological factors. In addition there are also personal attitudes or internal

factors that affect the performance of MSE, which are related to the person's individual attitude, training and technical know-how (Werotew, 2010: 226-37). Generally, there are external (contextual) and internal factors which are still affecting the financial performance of MSEs.

1.2.Statements of the Problem

The influence of financial management practices on performance is one significant topic in the field of entrepreneurship and MSE sector development as evidenced by an increasing number of publications and studies on the topic (World Bank, 2013). According to Ahmad et al. (2011), approximately 80% to 90% of SMEs fail within 5-10 years. In most developing countries, MSEs face constraints both at start up phases and after their establishment. The study conducted by Ethiopian CSA disclose that, the contribution of small enterprises in creating job opportunities and in the development of our economy is vital (FMSEDA, 2006:13). According to World Bank the MSEs are able to source and obtain finance mostly from informal sectors like friends and relatives while medium or large enterprises obtain funds from banks. This unequal access to finance by MSEs and medium and large enterprises has undermined the role of MSEs in the economic development in African countries (World Bank, 2004:29).

Poor management and accounting practices have hampered the ability of smaller enterprises to raise finance. Information asymmetries associated with lending to small scale borrowers have restricted the flow of finance to smaller enterprises. In spite of these claims however, some studies show a large number of small enterprises fail because of non-financial reasons (Liedholm, MacPherson and Chuta, 1994). Furthermore, study by Tushabonwe-Kazooba, (2006) revealed that poor record keeping and lack of basic business management experience and skills are major contributors to failure of small business. Researchers have also identified lack of access to external finance and weak capital base, inexperience in the field of business, particularly lack of technical knowledge plus inadequate managerial skills, lack of planning and lack of market research as causes of small business failure (Lussier 1996; Murphy, Shleifer and Vishny 1996; Van Stel and Storey 2004). The solution for solving problems of economic growth in developing countries often resides in the performance of small scale industries. It is expected that the gains to be derived from the establishment of small-scale industries will be translated into the generation of employment at a low investment cost.

According to Zeleke Worku (2009:1-9) lack of integration between the vocational curriculum taught at academic institutions and skills required at the workplace in small businesses and enterprises is a major obstacle to the growth and development of MSEs. Moreover, the study conducted by Ethiopian CSA discloses that, the contribution of small enterprises in creating job opportunities and in the development of our economy is vital (FMSEDA, 2006:13). However, their contribution is very low in compared with that of other countries due to financial problem, lack of qualified employees, lack of proper financial records, marketing problems, lack of working premises and raw materials. Lack of information about market opportunities and standards and regulation is one of the underlying factors that hinder their performance (Mulu Gebreeyesus, 2009:10-13).

In Addis Ababa, MSEs have a problem of finance when establishing the business. Most individuals sources of finance come from personal savings and loans acquired from relatives, friends and moneylenders with high amount of interest (MoTI, 2005:13-14). After the business goes operational, the probability of becoming profitable and paying back debts along with accrued interest is less. The rationale for selecting this study is based on an appreciation that the findings of study which aims to create meaningful results on the economic development and help reduce poverty. Micro and small enterprises in Ethiopia provide goods and services in promoting innovation and enhancing the enterprise culture, which is necessary for private sector development and industrialization. Therefore, this research was conducted to analyze the factors affecting the financial performance of Micro and Small Enterprises in kirkos Sub- city, Addis Ababa

1.3.Research Question

Mainly this research intends to answer what are the factors affecting the financial performance of Micro and Small Enterprises in kirkos Sub- city, Addis Ababa?; in pursuit of the main research question this study answer the following specific questions:

- What are the sources of finance or funds available to the MSEs?
- What are the external & internal factors that affect the growth of MSEs?

1.4. Objectives of the Study

1.4.1 General Objective

The main objective of the study is to assess factors that are mostly affecting the performance of MSEs in Kirkos sub-city of Addis Ababa.

1.4.2 Specific Objectives

- Examine the sources of finance or funds available for the start-up and the expansion of MSEs.
- Assess the internal & external factors that affect the performance of MSEs
- Investigate the contextual factors that affect the performance of MSEs
- Recommend possible solutions to alleviate the problem of MSEs

1.5. Significant of Study

The findings of this study would be useful to the stakeholders including: for academics, micro and small enterprise, and governmental policy makers. For academic world findings of this study assisted academicians in broadening of the prospectus with respect to this study; hence, providing a deeper understanding of the critical factors that affect the performance of MSEs is helpful; from the point of view of small enterprise the findings would help MSEs in Kirkos sub-city and others, within an insight into the benefits of using different factors studied in this research to predict the factors that affect the performance of MSEs. Further, this study also important for policy makers in that the government can use the findings of this study to assist in policy formulation and development for a framework for critical finance, marketing, work premises and other factors that affect the performance of MSEs. Moreover, the findings of this study would help the policy makers and financial institutions how to encourage establishing or expanding MSEs; and it also enables them to know what kind(s) of should be framed.

1.6. Limitation of the study

Most of the documents that are concerned with micro enterprises are written in Amharic, as a result to translate in to the required instruction language (English) takes longer period. Another problem encountered in this study has to do with the operator's reluctance to cooperate due to suspicion that disclosing information may lead to negative effect on their business. It is very

important to note that these limitations have been significant interference with the outcome of the study.

1.7. Scope of the Study

The study assessed factors affecting the performance of MSEs in Addis Ababa city particularly in Kirkos sub-city. Although, there are different issues that can be researched in relation to MSEs, this study is delimited to access to finance, working premises, and marketing.

1.8. Organization of the Study

The paper is organized as follows: Chapter one introduction, Chapter two presents the Literature Review, chapter three deals about research methodology, chapter four outlines presentation, analysis data and the last chapter, which is chapter five includes conclusions and recommendations.

CHAPTER TWO: LITERATURE REVIEW

2.1. Introduction

Micro-businesses sector is one of the driving forces of job creation, economic growth and poverty reductions in developing countries are one of the means through which acceleration of economic growth and rapid industrialization has been achieved (Scarborough & Zimmerer, 2008). Small and Medium Enterprise Development Policy (SMEDP) of Tanzania, indicated that Micro-businesses began to emerge after economic reforms that were introduced in 1986 and implemented in 1996 there by changing the economy of Tanzania to free market economy (The United Republic of Tanzania SMDEP, 2002). Contributions of micro-businesses are generally acknowledged as one of the key driver forces towards economic growth. Tushabomwe (2006) revealed that small businesses face different challenges that limit their survival and development. Majority of local entrepreneurs establishing micro businesses are susceptible to failure that is attributed to both internal factors (wrong pricing, negative cash flows, poor record keeping, management problems, lack of planning and faulty products) and external factors (government taxation, load shading, inadequate capital, poor markets and high rents).

According to Temtime and Pansiri (2004) sustainability and competitiveness and; internal managerial problems are identified as the major causes of small businesses failure. The managers of small businesses perform poorly in the areas of bookkeeping, marketing, warehousing, stock control, production scheduling and quality controls. Tushabomwe (2006), Temtime and Pansiri (2004) described that factors of small businesses failure lie on both internal and external.

Whereby, Taxation and load shedding contribute to more than 50% of the failures in small businesses. The most common factors of small businesses failure are management related challenges. The ability of managers to perform has a very important bearing on performance of small businesses (lack of education and professional training).

MSE is one of the institutions given recognition in the country's industry development plan. It serves as vehicles for employment opportunities at urban and it strengthens the economic development. MSEs also serve as sources of for sustainable job opportunities not only for developing countries like India and Ethiopia, but also for developed countries like USA, which is why policy Makers and scholars alike look at small-scale enterprises as important development agents in society. By offering possibilities to gain income, training, and work experience Micro

and small enterprises are said to provide livelihoods to millions of people worldwide (Altenbury/Eckhardt 2006). Moreover, donors and policy makers stylize small enterprise as drivers of private sector development.

2.2. Definition of MSEs

One major problem that arises while dealing MSEs is lack of clear cut and universally accepted definition. Attempts to define MSEs have led to a remarkable diversity of conceptions that actually generated debate as to the different approaches of defining MSEs. Firms differ in their levels of capitalization, sales and employment. Variables of definitions have been applied among different countries and different criteria have been considered to define them. But commonly, MSEs are considered to be non-subsidiary independent firms, which employ less than a given number of employees even though the number varies across countries.

Small firms are mostly considered to be firms with fewer than so employees while Micro-enterprises have at most ten, or In some cases, five employees (Malhotra, Chen, Criscuolo, Fan, Hamel, & Savchenko, 2006). In defining MSEs, in addition to considering number of employees engaged in the business, financial aspects such as turnover and total assets or balance sheet total are also taken into account. Especially, this has been used by international organizations like European Union, World Bank and others which are briefly described in the following tables, (i.e., Table 1 and Table 2).

Table 2.1: European Union MSE Definition

Firm Size	Head Count	Turn Over or Balance sheet Total
Micro	<10	< euro 2 Million
Small	Between 10 and 49	euro 10 – euro 49 Million

Source: IFC (2010)

Table 2.2: World Bank Group MSE Definition

Type of enterprise	Number of employee	Extent of total assets
Micro	1 – 10	Less than US \$100,000
Small	11 – 50	Between as \$ 100,000 and US\$3 Million

Source: Malhotra et al. (2006)

In Indian context, the level cumulative investments in plant and machinery or equipment have been chosen as the defining elements (Ministry of MSME, (2012). Under the MSME Act in 2006 enterprises have been defined by the present ceiling on investment to be classified as Micro and small enterprises is defined as follow (see table 3)

Table 2.3: Indian MSME Definition According MSME Act 2006

Type of enterprise	Sector	Installed Plant & Machinery
Micro	Manufacturing	Up to Rs.25 lakh(US\$ 50 Thousands)
	Service	Up to Rs.10 lakh(US\$ 20 Thousands)
Small	Manufacturing	Above Rs.25 lakh (US\$ 50 Thousands) & Up to Rs. 5 crore (US \$ 1 million)
	Service	Above Rs.10 lakh (US\$ 50 Thousands) & Up to Rs. 2 crore (US \$.40 million)

Source: Ministry of MSME, (2012), Exchange rate of US \$ 1= Rs.50 (April 2009)

The Ethiopian Modified definition of MSEs (Table 4) were brought and organized from foreign country experiences as well as correspondence analysis of previous definitions. The revised definition envisaged the other country experiences and actual economic circumstance such as inflation and exchange rates fluctuations in the country. Due to the rise in exchange rates and inflation, the minimum and maximum value of total asset's threshold used for classification of enterprises in into Micro and shall has been increased birr increased from birr 20,000 (US\$2500) to 100,000 (US\$6000) (maximum threshold for micro enterprise) and for small enterprise from birr 500,000 to 1.5 million maximum threshold (Government of Federal Democratic Republic of Ethiopia MSEs development strategy (GEDRE), 2011).

Table 2.4: Revised Definition of MSEs in Ethiopia

Type of enterprise	Sector	Number of employees Including family member	Total Assets
Micro	Industry	≤ 5	≤ 100,000 Birr(US\$6000)
	Service	≤ 5	≤ 50,000 Birr(US\$3000)
Small	Industry	6 - 30	≤ 1,500,000 Birr(US\$90,000)
	Service	6 - 30	≤ 500,000 Birr(US\$30,000)

Source: GFDRE (2011)

Financial institutions in Ethiopia lack a commonly agreed definition of MSE which leads to poor market segmentation along with a lack of in-depth customer knowledge and proper business strategy while the majority of Micro Financial Institutions(MFIs) use the MSE definition that is laid out in the government’s national MSE development strategy (table 3). Commercial banks do not seem to uniformly distinguish among small, medium, and large enterprise. Typically banks define MSEs according to the annual turnover of the business, loan size, and number of employees and/or revenues generated by financial institution. All MFIs besides one uniformly use the number of employees-criteria. Most of MFIs also categorize Micro and small enterprise in term of turnover and loan size.

Having a common MSE definition at national level would ease the design of loans, investments, grants, and statistical research. As we can understand from the above definitions, there is no universally acceptable definition of MSE. Different scholars define MSEs differently based on the level of development of the country under review. As show above, it is usual to see that different institutes define MSE differently using their own parameters.

2.3. The Role of Micro and small Enterprise in Poverty Reduction

Poverty in Ethiopia is widespread and remains a major challenge of sustainable development and stability (Lutheram world Federation of Ethiopia, 2006) cited in Eshetu & Mammo, (2009:2). By now, it is clear and agreeable that poverty, both in urban and/or rural areas, is all about lack of basic needs, low or inadequate level of income and consumption, poor command over resources, and high level of social exclusion, inequality and vulnerability. The role played by MSEs, through the various socio-economic benefits emanating from the sector was found to be eminent in overall development effort and process of nations. In other words, by generating larger volumes of employment as well as higher levels of income, the MSEs will not only have contributed towards poverty reduction, but they will also have enhanced the welfare and standard of living of the many in the society (Mukras, 2003: 58-69).

Current International thinking is in tune with a view that acknowledges MSEs as tool to fight poverty in the long run. The UNIDO approach to this worth mentioning here:

Poverty reduction is simply not going to happen by government fiat but only through private sector dynamism. The evidence directly linking MSEs and poverty reduction is considerably less robust than that linking them to economic vitality, even in the most developed economics. There are suggestion of greater employment opportunity for poor, low skilled workers, increased skills development and broader social impacts. The movement to support MSE development internationally reflects a return to promoting poverty reduction by investing in private sector driven strategies by all of the major multilateral agencies. Poverty reduction strategies (PRSs) currently being formulated in Many developing countries places a more pronounced emphasis on the contribution that the private sector will have to make compared to the over reliance on the social agenda that characterized earlier PRSs (Perumal K. & Prasad n.d:2-29).

In conformity with the above view advanced by UNDO and as an organization concerned to the condition of lab our, the ILO's approach to poverty reduction is through small enterprise development. This strategy focuses on the needs of poor people who are part of the MSE economy as owners/operators and workers, as their dependents, as unemployed who may benefit from job creation and as customers.

While further strengthening the above shown approach, Vandenberg (2006:18) suggests that: The ILO's existing strategy for poverty reduction through small enterprises must emphasize the fact that small enterprises make a positive contribution to poverty reduction when they provide employment, adequate levels of job quality, and low cost goods and services used by the poor; entrepreneurship, combined with productivity increase, is a key ingredient for poverty reduction through small enterprise development; and vibrant enterprises, competitive markets and a fair globalization can make a significant impact on poverty reduction.

In Ethiopia, MSEs are the second largest employment generating sector next to agriculture. A nation survey conducted by central statistics Agency (CSA) (2003) indicated that more than 1.3 million people in the country are engaged in informal sector and small Manufacturing businesses.

The MSEs, are also an important force to generate employment and more equitable income distribution to activate competition, exploit niche markets, enhance productivity and technical change, and through all of these stimulate economic development, Therefore, the government of Ethiopia has recognized and paid due attention the promotion and development of MSEs, for they are important vehicles to address the challenges of unemployment, economic growth and equity in the country. To this effect, the government has formulated a national micro and small enterprise development and promotion strategy, which enlightens a systematic approach to alleviate the problems and promote the growth of MSEs (MoTT, 1997).

2.3.1. Micro and Small Enterprise for Economic Growth Arguments

There are two polarized thoughts according to (Agyapong, 2010: 196-205: Anderson et al., 1994:129-133 and Staley & Morse, 1965:31) the role and contribution of MSE to economic growth and poverty reduction; 'Pro' and 'Contra' Arguments. Their works often classified as the classical and modern theories on MSE's development. The contra arguments predict that advantages of MSEs will diminish overtime and large enterprise (LEs) will eventually predominate in the course of economic development Marked by the increase in income. In line with these shortcomings and pessimism Admassie and Matambalya (2002:1-29), for Instance, Concluded that high Level of technical inefficiency, which reduce their potential output levels significantly. Research carried out by Biggs (2002 cited in Tegegne and Meheret,2010:14)

strongly question the role played by MSEs to Minimize the incidence of high level poverty in most developing economies through employment creation, income generation and multiplier effects on other sectors of the economy.

While, the pro argument views based on experiences from many countries showing the ‘Contra’ arguments, seem to get less supports as many international agencies, including the World Bank (2004:41). The World Bank gives three core arguments in supporting MSEs in LDCs, which in line with the arguments of the Modern (Pro) paradigm on the importance of MSEs in the economy (word bank, 2002 and 2004 cited In Tulus T., 2006:5).

First MSEs enhance competition and entrepreneurship and hence have external benefits on economy wide efficiency, innovation and aggregate productivity growth. Second, MSEs are generally more productive than large enterprises but financial market and other institutional failures and not conducive macroeconomic environment impede MSE development. Third, MSE expansion boosts employment more than large enterprises growth because MSEs are more labor intensive.

In other words, the World Bank believes that direct government support for MSEs in LDCs help these countries exploit the social benefits from their greater competition and entrepreneurship, and their MSEs can boost economic growth and development.

The above arguments do not mean, however, that large enterprises are not important, or MSEs can fully substitute the role of LEs in the economy. Even, there are skeptical views from many authors about this World Bank’s pro-MSE policy. Some authors stress the advantages of large enterprises and challenge the assumptions underlying this pro-MSE policy. Specially, large enterprise may exploit economies of scale and more easily undertake the fixed costs associated with research and development (R&D) with positive productivity effect (Tulus Tabunan, 2006:5).

2.4.Factors that Affect Small Scale Enterprise

2.4.1. Internal Factors

In most of the studies done the commonly cited cause of small businesses failure is poor management. Although it is not easy to recognize what constitutes poor management, the

majority of small businesses problems are characterized as managerial (Scarborough & Zimmerer, 2008).

2.4.1.1. Management Capacity

Entrepreneurs put their faith in common sense, overestimate their managerial skills, or believe that hard work alone can ensure success. If a small business manager does not know how to make decisions and does not understand the basic management principals, there, he is likely to face managerial challenges in the long run if not failure to progress with business activities (Griffin & Ebert, 2006). Small businesses managers need to have experience in the field they want to enter. The experience will provide practical understanding as well as knowledge about the nature of the business, which will spell out the difference between failure and success (Scarborough & Zimmerer, 2008).

2.4.1.2. Control System and Inventory

Effective control system keeps the business in track and alert managers of any potential danger. If any control does not signal any impending problems you may seriously be troubled, then such controls are ineffective (Griffin & Ebert, 2006). Scarborough and Zimmerer (2008) argue that; the largest investment a small business makes is in inventory yet inventory control is one of the most neglected managerial responsibilities. Insufficient inventory levels results in shortages and stock outs causing customers to become disillusioned and leave. More common situation is that the manager has too much inventory, but also too much of the wrong type of inventory. Many small businesses that fail due to poor inventory control, have excessive amounts of cash tied up in an accumulated useless inventory.

2.4.1.3. Planning

Many small businesses do not realize the importance of planning to their firms' success. Often managers of small businesses neglect the process of planning because they think that it is something that benefits only large companies. Failure to plan a firm's future will have a devastating effect on the firm existence. This often manifests itself in two ways; Lack of strategic plans (Strategic plan plots the overall direction of the business and identifies the ways of maximizing its strengths and overcoming its weaknesses) and unplanned expansion (Growth is natural, healthy and desirable part of any business).

But, it must be planned carefully. Expansion should be financed by the retained earnings or capital contributions from owners, but most small businesses wind up borrowing at least a portion of their capital investment). As the business increases in size and complexity, problems tend to increase in proportion and the managers must learn how to deal with it. Sometimes entrepreneurs encourage that eventually the business outstrips their ability to manage. (Griffin & Ebert, 2006)

2.4.1.4. Location and Pricing

For many small businesses choosing the location is partly a science. Too often business locations are chosen without proper study and planning. Location is much too critical to be left to chance. Some beginning owners choose a particular location just because they have seen a vacant place or building (Scarborough & Zimmerer, 2008; Lambing & Kuhl, 2007). Entrepreneurs need to establish prices that will earn necessary profits by first understanding what it costs them to make, market, and deliver their products and services. Small businesses owners often underprice their goods and services resulting to losses that ultimately cause their failure (Tootelin & Gaedeke, 2002).

2.4.2. External Causes of Small Business Failure

2.4.2.1. Startup Capital.

Lack of funds could lead to excessive borrowing and consequently business becomes insolvent because their liabilities are higher than their assets. According to Dwivedi (2005), the role of financial institution is to facilitate the flow of funds from individual surplus spending units to deficit spending units. The whole of this process is called money market. And according to this author, the money market reaches its equilibrium where demand for money equals supply of money. The author adds that, to business firms or enterprises, money is the producer's good much as machinery or inventories, thus in order to attain growth of any business, especially small sized ones, the business enterprise should acquire additional capital through the capital market in order to maximize their returns. Longenecker et al. (1997) stated that economies of scale virtually prohibit small businesses from always although frequently and sometimes using other sources of finance such as public stock issues.

2.4.2.2. Government Regulations

Government regulations like taxation are regularly well intended and they benefits without question. However their costs to small businesses are relatively higher as a result small businesses normally do shift the burden of those costs to customers. Government regulations have been accused of distorting free markets by impeding competition (Susman, 2007). Tanzania Government Sector Study of the Effective Tax Burden (2006) suggests that tax and incentive policies are key parameters in defining a business climate. Taxes are essential for the financing of government activities such as social and economic development programs in the country, but at the same time, they should be set and administered to be as growth enabling as possible. In Tanzania the revenue raising authorities are the Ministry of finance that set tax policies and Tanzania Revenue Authority (TRA) that administers tax collection practice. Various laws and legislations have been enacted to guide the administration and collection of different taxes within the country and country that constitute the East African Community.

2.4.2.3. Access to Capital and High Cost of Finance.

During the early stages of starting business many owners commit themselves to taking any sources of finance they have available to them. This can be disastrous as high interest rates and unfavorable payment schedules are overlooked due to pressure of financing their business. For the entrepreneurs taking high risk borrowing is simply a choice between starting a business and never starting the business. The best source of finance to small business can often be family and friends contributions but pay back in time. Small businesses are particularly vulnerable in periods of high interest rates because they rarely heavily on financial institutions for seasonal borrowing (Susman, 2007; Lambing & Kuhl, 2007).

➤ Financial Controls

Are the written ‘rule’ and procedures that let everyone know what should happen- who can do what, when and how. These include for example, who can sign check, which maintain the cashbooks, and how the petty cash is administered. Some of these rules will be laid down by the constitution or memoranda and articles of association, in the case of registered companies) and others may simply be unwritten understandings, or ways of working traditionally adopted by the

management committee (MC) or staff of the organization/business. All organization should have financial controls to ensure effective financial management (Basis Project Team, 2008).)

➤ **Business Cycles and Inflation**

This consists of recessions and depressions. Small businesses are strongly affected by these economics ups and downs. Rescissions and business low downs always cause quantum leap in the rate of small business failure. When recessions occur during a particular time, many businesses are being affected and this could end up making some to be closed since they could not cope-up with the situation. Because small businesses are more susceptible to swings in the economy, they are more likely to fail during rescissions (Susman, 2007). Tushabomwe (2006) ascertains that lack of capital was an impediment in the early stages of small businesses. Small businesses failed because they were started with limited amounts of capital. Also micro businesses lacked collaterals that could be deposited to get loans provided by microfinance institutions

2.5.The Micro and Small Enterprise in Ethiopia

Having recognized the importance of the MSEs sector to the economy, the Federal government of Ethiopia has issued a MSEs Development strategy in 1997 followed by the proclamation for the establishment of the Federal Agency for MSEs Development in 1998 (MOT,1997).

MSEs caught the attention of development practitioners and policy makers recently not only because of their importance in terms of employment but also because of various other attributes.

Some of these are:

- MSEs are breeding, ground for entrepreneurs
- The sector has high employment generating capacity, and it less capital intensive.
- It is highly competitive, flexible and Innovative

MSEs have been given due attention Since 1997 E.C as that have invaluable contributions in economic development of countries like other sectors. In 2010/11, the government has approved a revised MSE development policy and strategy. The revision was necessary among others; to draw useful lessons from implementing the program during previous years, to sustain past gains

or achievements in to GTP period and, to incorporate international best practices or improved experiences of other countries.

The national profile (FMSEDA, 2013) of MSEs indicates that by the end of 2011/12, 217,636 MSEs were organized in the regions and urban across the country of which 201,758 or (92.7%) are Micro enterprises. At their start-up, the enterprises had 540,602 members. Of which 36.5% were female. Currently, the enterprises have 690,749 operators (37.4% female members), which indicates 27.8% increase in total members.

Regarding the duration since the start-up, from the total 217,636 MSEs 19.0% started operation before 2007/08, currently have operational experience more than five years. Most of these enterprises were organized during the past three years, thus have few years' experience. This also indicates government's better attention and effort to developing the MSE sector during recent years.

During Previous years the government has been providing comprehensive support to existing and newly organized MSEs; including provision of training, access to credit, promoting market linkage (domestic & foreign), support in technology transfer, provision of operating and marketing premise or plots.

Referring to provision of operating and marketing premises, during the reference period about 10,759.7 hectare plots of land, 15,611 sheds, and 1,236 buildings have been transferred to a number of MSEs operations in different cities across the country. With reference to creating access to credit, about ETB 7.189 billion loans was extended to 661,227 beneficiaries during the period.

In reference to promoting market linkage, during the period about ETB 15,922 billion local and foreign market linkages was created.

Thus, training was provided to 3,082,331 operating during 2008/09-2011/12. Regarding the specific kind of training, from the 2,080,295 operators that took training 2010/11-2012/13, 49.2% participated in a training program on entrepreneurship or business management, whereas the remaining 50.8% benefited from technical skills training.

During 2009/10-2012/13, 4,330,657 permanent and temporary job opportunity was created nationally by the MSEs sector, from which 3,091,575 (71.4 percent) was creating during the last

four years, which the average share of MSEs employment from total formal employment was 67.7% during the previous four years.

Currently, the Ethiopian government has given priority and planned to work progressively on MSEs to complement with the objective of the 5 years of Growth and Transformation plan (GTP II) that is focuses on Industrial development in the country. The sector is expected to play as significant role as an instrument in curbing the challenges of unemployment, poverty and to accelerate economic growth.

2.6.The Concept of Business Performance

According to Martin (2010:671) performance is defined simply in terms of output terms such as quantified objectives or profitability. Performance has been the subject of extensive and increasing empirical and conceptual investigation in the small business literature (Bidzakin K.G., 2009:31). The issues that remain and from whose perspective the goals should be established (Etzioni, n.d:128). Rami Alasdair and Ahmed Abdelrahim (2007:6-13) on the other study defined performance as follows.

The most commonly adopted definition of success (good performance) is financial growth with adequate profits. Other definitions of success (good performance) are equally applicable. For example, some entrepreneurs regard success (good performance) as the job satisfaction they derive from achieving desired goals. However, financial growth due to increasing profits has been widely adopted by most researchers and practitioners in business performance models.

Global Entrepreneurship Monitor (GEM) defined performance as the act of performing; of doing something success fully; using knowledge as distinguished from merely processing it (GEM, 2004:10). However, performance seems to be conceptualized, operational zed and Measured in different ways thus, making cross-comparison is difficult (Srinivasan et al., 1994:22). Among the most frequently used operational are survival, growth in employees and profitability.

A business enterprise could measure its performance using the financial and non-financial measures. The financial measures include profit before tax and turnover while the non-financial measures focus on issues pertaining to customers' satisfaction and customers' referral rates,

delivery time, writing time and employees' turnover. Recognizing the limitations of relying solely on either the financial or non-financial Measures, owners-managers of the modern small business has adopted a hybrid approach of using both the financial and non-financial measures (HGin Chong, 2008:13).

2.7.Review of Empirical Studies

According to Mead & Liedholm (1998:69) and swierczek and Ha (2003:46-58), the main factors that affect the performance of MSEs in developing countries is not their small size but their isolation, which hinders access to markets, as well as to information, finance and institutional support. The argument that small businesses in Africa are Crucial in the role they play in employment creation and general contribution to economic growth is not new. Although this may be true, the vast majority of new enterprises tend to be one-person establishments (Murega, 1991:33-36). This has tended to ensure that the Journey of the MSE entrepreneur in many instances is short lived, with the statistic of MSE failure rate in Africa being put at 99 percent (Rogerson, 2000:41). Various reasons for these failures have been proposed by scholars including lack of supportive policies for MSE development (McCormick 1998:26-27), intense competition with replication of micro-businesses Manning&Mashego,1993:59-61); Manager characteristics including lack of skills and experience (katwalo & Madichie, 2008: 337-348 and verhees, F.M.,& Meulenberg.M.U., 2004:134-154).

A study by Hall (1992:237-250), has identified two primary causes of small business failure appear to be a lack of appropriate management skills and inadequate capital (both at start-up and on a continuing basis). The research undertaken in Tanzania by surveying 160 Micro enterprises should that high tax rates, corruption and regulation in the form of licenses and permits, are found to be the most important constraints to business operations of Micro enterprises (Fjeldstad et al, 2006 Cited in Mulugeta, 2011:22).

Roy and wheeler (2006:452-464), identified that the level of training of Micro entrepreneurs (both formal and informal): experience and number of years in operation: Knowledge of the market: level of differentiation (In terms of prices, quality or other) and diversification of products: access to the necessary resources and/or technologies; level of planning: Vision for

future; and the entrepreneur's level of poverty are among the factors inhibiting the growth and development of the Micro enterprise sector.

Mainly relying on a sample survey of 557 operators and 200 MSEs chosen from four major cities of Ethiopian namely Adama, Hawassa, Bahirdar and Mekelle, Tagegne and Mehert' research (2010:40-72), was conducted with the intention of assessing the contribution of the MSE strategy to poverty reduction, job creation and business development. The raised cause for this gloomy prospect of business were not growing (33%), lack of finance (13%), lack of market (11%) and lack of working space (4%).

The major constraints identified by various studies on MSEs in Ethiopia are associated with market and finance problems. The cause of market related problems of MSEs engaged in metal and wood work are shortage or absence of marketing skills, poor quality of products, absence of market research, shortage of market information, shortage of selling places, and absence of sub-contracting (FMSEDA, 2006:34).

In his research, Dereje (2008:47) studied the nature, characteristics, economic performance, opportunities and challenges of MSEs in the construction sector based on 125 sample enterprises. The results of the study revealed that the main constraints of the MSEs were shortage of capital, lack of raw material, absence of government support, lack of market lack of credit facilities and high interest rate.

Studies were also conducted specially with the purpose of identifying the problems that MSE encounter. For instance, Workneh's (2007:51) research undertaken in Kolfe Keraneo sub city of Addis Ababa indicated that lack of capital, lack of market, unfavorable policy, and inadequate infrastructure, absence of adequate and relevant training, bureaucratic structure and procedure are among constraints faced by MSE. Similarly, Adil's (2007:63) research carried out in Addis Ababa shows that inappropriate government intervention, shortage of capital, location disadvantage, lack of market and lack of display room are the major challenges that abstract MSE.

Mulugeta (2011:72-77) has identified and categorized the critical problems of MSEs into market related problems, which are caused by poor market linkage and poor promotional efforts; institution-related problems including bureaucratic bottlenecks, weak institutional capacity, lack

of awareness, failure to abide policies, regulations, rules, directives, absence of training to executives, and poor monitoring and follow-up; operator-related shortcomings like developing a dependence tradition, extravagant and wasting behavior, and lack of vision and commitment from the side of the operators; MSE-related challenges including lack of selling place, weak accounting and recording keeping, lack of experience sharing, and lack of cooperation within and among the MSEs and finally society-related problems such as its distorted attitude about the operators themselves and their products.

Eshetu and Zeleke (2008:2-9) conducted a longitudinal study to assess the impact of influential factors that affect the long-term survival and viability of small 25 enterprises by using a random sample of 500 MSMEs from 5 major cities in Ethiopia. According to this research, that lasted from 1996-2001, the factors that affect the long term survival of MSMEs in Ethiopia are found to be adequacy of finance, level of education, level of managerial skills, level of technical skills, and ability to convert part of their profit to investment. This is so because the findings of the study revealed that businesses that failed, during the study period were characterized by inadequate finance (61%), low level of education (55%), poor managerial skills (54%), shortage of technical skills (49%), and inability to convert part of their profit to investment (46%). The study further indicated that participation in social capital and networking schemes such as *Iqub* was critically helpful for long-term survival of the enterprises. Businesses that did not participate in *Iqub* schemes regularly were found to be 3.25 times more likely to fail in comparison with businesses that did, according to the study.

In their study, based on the survey covering 123 businesses units in four *Kebeles* of *Nifas Silk-Lafto* and *Kirkos* sub-cities of Addis Ababa, and aimed to investigate the constraints and key determinants of growth, particularly in employment expansion, Paul and Rahel (2010:89-92) found out that the studied enterprises registered 25% increment in the number of total employment they created since their establishment with an average annual employment rate of 11.72%. With regard to the sources of initial capital of the studied enterprises, the study indicated that, the main ones were loan from MFI (66.7%), personal savings/*Iqub* (17.5%), and loan from family/friends (17.1%). Moreover, the concrete problems that the targeted MSEs faced at their startup were lack of capital (52.8%), skills problem (17.9%) and lack of working space (17.1%). Moreover, Daniel (2007:49), identified that lack of raw material, stiff competition and shortage of working capital.

In reality, literature on MSE in Ethiopia is scanty and most of the availability studies were not conducted in line with performance aspects of Micro enterprises. However, this research tried to assess factors affecting the performance of MSE, in a holistic way by targeting and deeply investigating those operators engaged in textile and garment, food processing and metal and wood activities in kirkos sub city of Addis Ababa.

CHAPTER THREE: RESEARCH METHODOLOGIES

3.1 Research Design

For the purpose of this study a descriptive research design was employed. Research design can have a number of classifications which could incorporate the degree to which the research question has been crystallized, the method of data collection, the ability of the researcher to produce effects in the variables which are being studied, the purpose of the study being carried out, the time dimension, the focus of the study and also the research environment (Njambi 2014). A descriptive study collects data in order to answer questions about current status of the subject or topic of study; the researcher believed that a descriptive research design were appropriate for this study because this study is intends to describes and critically assesses the factors affecting the financial performance of MSEs in kirkos sub-city of Addis Ababa.

3.2 Data Collection

The study employed both primary and secondary sources of data collection. In order to realize the target, the study used well-designed questionnaire as best instrument. This was completed by the owner managers/ or operators of the enterprises. Besides, face-to-face interviews with the MSEs Operators/and the relevant owner managers who heads the enterprises in the food processing, textile and garment and wood and metal work sectors. Furthermore, the study also used a secondary data source, these data was collected from files, financial records and report, pamphlets, office manuals, circulars and policy papers. This helps to provide appropriate additional information. Besides, variety of books, published and/or unpublished government documents, websites, reports and newsletters were reviewed to make the study fruitful.

3.3 Sampling Strategy and Procedures

According Barreiro & Albandoz (2001) the reasons to use sampling is first of all, there is a big need of time, and second of money, because it is necessary to employ many people to make the interviews, pays their trips to let them go to every village, etc. Moreover, there is an additional difficulty: it is complicated to get to each and every Spaniard, because when we make the interviews, there will be people in hospitals, in a trip to a foreign country, etc. In this situation, for economic reasons, it will be convenient to interview a certain part of the population, a

sample, chosen in an appropriate way so that we can obtain later conclusions for the whole population. In the second situation we have a different difficulty. If we want to know the lasting of a certain battery, we have to use it until it is over. Therefore, somehow we destroy this element of the population. If we would have to try each and every battery of the population, we would keep none of them. Thus, what we should do in this situation is also to choose an appropriate sample and then we could take the appropriate general conclusions.

3.3.1 Population

The population of this study covers all formally registered as MSEs in the category of textile and garment, food processing and wood and metal works until June 2015 by Kirkos sub city administration trade and MSEs development agency. Totally there were 1350 MSEs.

3.3.2 Sample Size and Sampling Technique

The Kirkos sub-city was purposely choose among the ten sub-city of Addis Ababa, as a study area for this study. This is because it is nearness and convenience to collect the data in short time. In this study these selected textile and garment, food processing, metal and wood work sectors are taken as sample area because of the following rationales. First, the sector are selected because of largest concentration in number compared to other sectors the sub-city; Second, it is difficult to reach the operators/or owners managers of some sectors like municipality service parking and others.

Two stage sampling were employed to get information from different sizes of the MSEs. On the first stage 180 MSE were selected purposely which are engaged in textile and garment, food processing and metal work and in the second stage 125 sample respondents were selected randomly based on the following description.

Yamane (1967 : 886) cited on Israel (2013) provide a simplified formula to calculate a sample size which is show in the following equation:

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

Where, n is the sample size, N is the total population or sampling frame, and *e* is the level of precision. Using these formula 125 pharmacists was taken as a sample.

3.4 Data Analysis Technique

The purpose of analyzing data is to obtain usable and useful information. The analysis, irrespective of whether the data is qualitative or quantitative, may: describe and summaries the data, identify relationships between variables, compare variables, identify the difference between variables, and forecast outcomes. Accordingly, considering the objectives of the study; to assess factors that are mostly affecting the performance of MSEs, the study utilized descriptive research approach which was descriptive statistics such as percentage and frequency tables.

3.5 The Conceptual Framework

Conceptual Framework means that concepts that relate to one another were used to explain the research problem. Since business performance is influenced by both internal and contextual factors, operators need to understand what influenced business to reach peat performance. The conceptual factors include Access to loan, working premises and marketing factors. The influence of those factors to the firm performance is very important but it is noteworthy that the management has no (little) control over them (Wanjiku, 2009:81-82).

Nevertheless, the factors must be closely monitored to ensure that stringent measures are taken within the best time to either take advantage of the opportunities of or combat the threats found in the external environment. The Internal factors that influence the firm's performance can be classified as financial management practice particularly record keeping and maintain bank accounts. To align the conceptual framework with the research objectives, business performance is the dependent variable whereas access to loans, working premises, marketing, financial management Practices and entrepreneurial factors are all independent variables. The relationship can be expressed and shown in figure 3.1

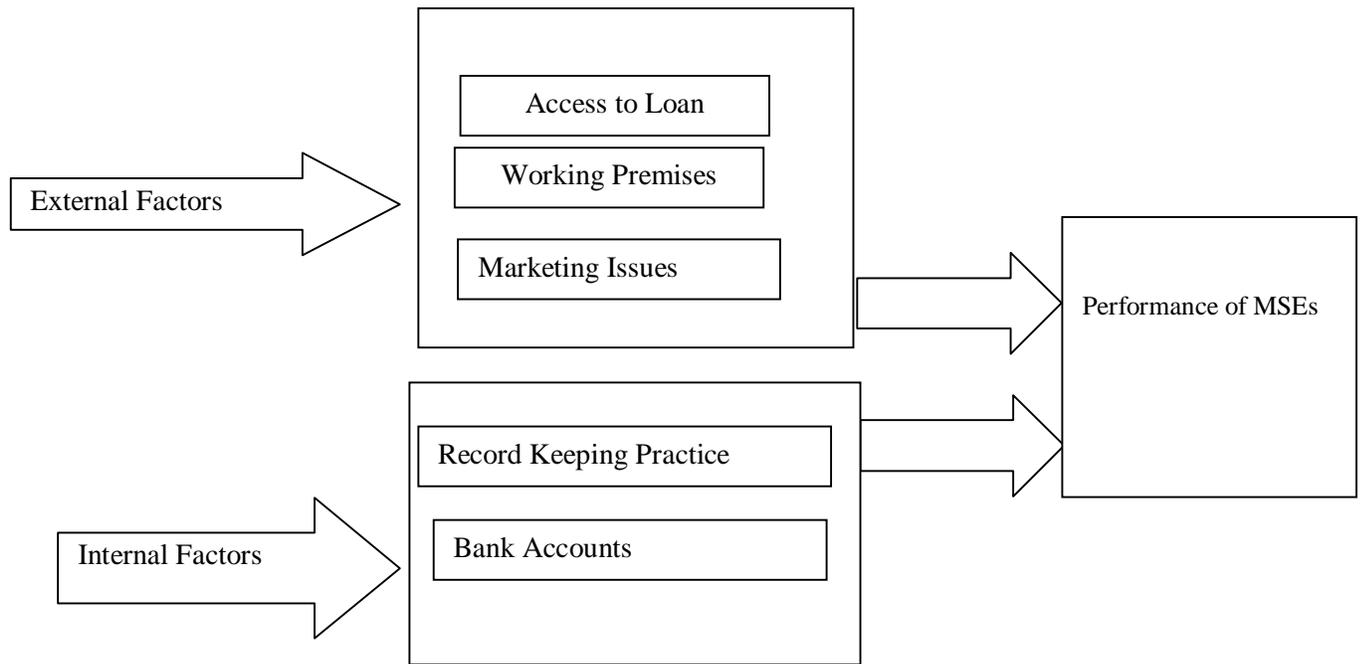


Figure 2.1 Conceptual Frameworks (Own Model)

CHAPTER FOUR: PRESENTATION AND ANALYSIS OF DATA

The purpose of this study was to critically assess the factors affecting the performance of MSEs in Kirkos sub city. Data were collected from operators or owner managers of MSEs found in Kirkos Sub city. One hundred Twenty Five (125) questionnaires were distributed across the three types of MSEs in the sub city, out of which 100 respondents are completed and retrieved successfully, representing 80% response rate. The ratio 125 questionnaires administered 33, 60, and 32 were distributed to textile and garment, food processing and wood and metal work respectively. The numbers of questionnaire retrieved from textile and garment, food processing and wood and metal work are 25, 48 and 27 also respectively. This represents a response rate of 76%, 80% and 84%, for textile and garment, food processing and wood and metal work respectively.

4.1.Socio Economic Characteristics of Respondents

4.1.1. Sex and Age of Respondents

According to the survey result 66% of the respondents were male whereas 34% were female. Apparently, 57% of respondents fall in the age group of 18-30 years, 36% were in the age range of 31-45 and the rest 7% were between the age ranges of 46 to 55 years. Moreover, seeing individually male and female, from male respondents 50% of them were between 18-30 years, 42.42% and 7.57% of male respondents were in the age range of 31-45 and 46-55 years of age respectively. Likewise, out of female respondents more than 70% of them were in the age range of 18-30 years, 23.52% of them between 31 and 45, and the rest 5.88% were between 46 and 55 years of age (table 4.1).

Table 4-1 Description of Age vs. Sex of Respondents

Age of Respondents	Sex of Respondents				Total	Percent
	Male	Percent	Female	Percent		
18-30	33	50%	24	70.5%	57	57%
31-45	28	42.42%	8	23.52%	36	36%
46-55	5	7.57%	2	5.88%	7	7%
Total	66	100%	34	100%	100	100%

Source: Own survey

Furthermore, the analysis indicate that in terms of proportion majority of the respondents were males, this may implies the most of the MSEs business were engaged and dominated by males; likewise, majority of the respondents in the fall age group of young which is also known as productive age, this may indicate young people are involved in this type of business.

4.1.2. Marital Status and Education level of Respondents

The marital status contains only three categories single, married, and divorced. Hence, 75% of the respondents were single, 23% of them were married and the rest 1% of the respondents were divorced (table 4. 2). With regard to the educational status of the respondent’s there were three categories diploma, degree and master’s degree holders. Accordingly, more than half (55%) of the respondents was a degree holder, the rest 44% and 1% were diploma and master’s degree holders respectively. Taking as a group, comparatively majority of the respondent who were single are a diploma and degree.

Table 4-2 Marital status vs education level of respondents

	Education level of respondents						Total	%
	Diploma		Degree		Masters			
Marital status	Freq	%	Freq	%	Freq	%		
Marital status Single	31	70.45%	44	80%	0	--	75	75%
Married	12	27.27%	11	20%	1	100%	23	23%
Divorced	1	2.27	0	--	0	--	1	1%
Total	44	100%	55	100%	1	100%	100	

Source: own survey

4.1.3. Business Classification

The table below depicts about the business classification of micro and small scale enterprises. Accordingly around half (48%) of the respondent were engaged in food processing business, the rest 27% and 25% of the respondents were engaged on wood and metal work and textile and garment business respectively (table 4.3). One of the policy of the country is ADLI (Agricultural development led industrialization), which is through time increase and support the economy the country through industrialization.; that is why most of MSEs engaged in manufacturing type of

business. Therefore, through time this small scale type of industries would change to large scale industries.

Table 4.3 description of type of business engagement of MSEs

No	Business type	Frequency	Percent
1	Textile and garment	25	25%
2	Food processing	48	48%
3	Wood and metal work	27	27%
	Total	100	100%

Source: own survey

4.2. Factors Affecting the Performance of Micro and small Enterprises

4.2.1. Source of Funds to Start-up and Expansion

Starting own business requires a starting capital rather than more existence of ideas. To capture information regarding the relative importance of the various source of finance. MSEs Representatives asked whether they ever received credit from each of a given list of source of finance. Accordingly the respondents said that their organizations are financed from various means. Proportionally from Micro finance institutions 11%, Equb/Idir 17%, Friends/Relatives 14%, Personal saving 36%, Family 16%, NGOs 4%, and from Banks 2%. This indicated that most of the start-up capital for MSEs was their personal savings, Equb/Idir and family respectively and almost MSEs didn't have access to bank loan (table 4.4).

Table 4.4 description of source of fund

No	Source of fund	Frequency	Percent
1	Micro finance institution	11	11%
2	Equb/Idir	17	17%
3	Friends/ Relatives	14	14%
4	Personal saving	36	36%
5	Family	16	16%
6	NGOs	4	4%
7	Banks	2	2%
	Total	100	100%

Source: own survey

4.2.2. Access to Support Services

Generally there are many external and internal factors that impacts MSEs Growth. The major one, among others, includes providing working premises, trainings, consultancies, and organizing in clustering and others for to the enterprises improved performances. The data collected from the enterprises from Kirkos sub city of Addis Ababa reveals that most of the MSEs complain about Lack of Finance (42%) to expand their business followed by Lack of working premises (28%): while the third constraints factor is identified to be lack of access to market or absence of linkage to market which was responded by 30% (table 4.5).

Table 4.5 description of areas of support for MSE

No	Access to support service	Frequency	Percent	
1	Lack of finance	42	42%	
2	Lack of working premise	28	28%	
3	Lack of access to market	30	30%	
	Total	100	100%	

Source: own survey

According to the respondents the above mentioned problems were the critical issues for the development of micro and small scale enterprises. Furthermore, according to some of the key informants because of lack of finance or because of lack additional loan they were unable to extent and diversify their business as expected and wanted. The detail of the factors were discussed below here:

4.2.2.1. Access to Loan

It is clearly indicated that in the strategy that government facilitate provisions of loan services at preferential interest rate to micro and small enterprises in the nation during the specified time. Though such instruments are very supportive for the growth of MSEs, availability and quality of this support instruments has its own impact on the growth.

Table 4.6 Analysis of credit access to MSEs

No	Type of enterprise	Access to credit				Total
		No	Yes	Not stated	I don't know	
1	Textile and garment	19	5	1	0	25
2	Food processing	38	7	1	1	48
3	Wood and metal work	21	3	2	2	27
	Total	78	15	4	3	100%

Source: own survey

The data collected on this issue reveals that the majority of the MSEs (78%) had not received any credit service in the sub city. Access to finance remains a top obstacle for enterprises of the sub city. Moreover, despite confirming their need for improved access to finance, MSEs are discouraged from applying for loans due to excessively high collateral requirement. High collateral requirement are a binding constraint for smaller MSEs since the most common type of collateral used are land and buildings or personal assets. The rest 15% and 4% of the respondents confirm that they didn't get credit service and they totally not stated in the credit service respectively (table 4.6).

Furthermore, according the respondents response financing their business has been become a principal challenge to micro and small scale enterprises in Kirkos Sub city MSEs. More over banks do not provide finance in the form of loan to MSE's due to collateral obligations and other requirements.

4.2.2.2. Access to Work Premises

It is evident that the respondent of this study briefed that the performance of their businesses is dependent up on the amount of working premises availed to them. Especially, newly created ones, as they cannot afford to rent/buy the land on the market value, need to be supplied with land. And, in most cases this variable affects their performance. Operations MSEs particularly metal and wood work are land intensive activities and their performance highly depend on the availability of land. The MSEs are not getting the required land because of lack of awareness

from the officials' side and scarcity of the land in their sub city. As a result complaining about this crucial resource are common in the area of study as the respondents said.

Table 4.7 description of access to premises received

Land received		
	Frequency	Percent
Yes	28	28%
No	72	72%
Total	100	100%

Source: own survey

The data gathered from the field in the sub city indicate that only very few MSEs are receiving this resource. Accordingly, around 28% of those MSEs have received land from the government for their operations. Therefore, one should not wonder to see most of them stagnating in their growth. The majority of them, 72%, have responded that they have not received any plot of land from the government. In such cases, it is witnessed that the enterprises are renting from private individuals, which actually entails to pay huge cost on the small operators (table 4.7).

4.2.2.3. Access to Marketing

Marketing knowledge is important for the promotion, growth and development of micro and small enterprises. In this regard, the Ethiopian government has formulate MSE's strategies to ease marketing challenges by creating inter-linkage mechanisms with other institutions providing training on marketing, developing export support programs and marketing center according the secondary documents compiled from the MSEs. However, inability to see the products and services: Lack of adequate marketing channels and lack of marketing skills are the problems to starting the business and further growth of the sector as respondents said during the researcher visiting them. Accordingly, majority (68%) of the respondent replied that they didn't have market access, on the other way, 32% of the respondents confirm that market access was provided to them (table 4.8)

Table 4.8 description of market access

Access to Marketing		
	Frequency	Percent
Yes	32	35%
No	68	65%
Total	100	100%

Source: own survey

4.3. Financial Management Practice and MSE Performance

According to the respondents' point of view, they believe entrepreneurs of micro and small enterprises start well, but somewhere down the line, in their day-to-day operations they miss the route of success. In more than half such cases the reasons identified can be attributed to financial mismanagement. At that time, they have a feeling of wellbeing but year-end consolidation of accounts indicates a disastrous situation, loss or almost being on the verge of losing.

At other times, opportunities come by but cannot be grabbed. Reasons for such inadequacies can be inability to think of source of funds or rigidity on the part of the banker. The banker's non-cooperation, most often, is due to entrepreneur's inability to maintain accounts and strongly present his case. All such problems can be suitably tackled if, all along, an entrepreneur keeps uppermost in his day-to-day operations certain considerations in financial management. Moreover, the respondents added a successful MSE person must not only be very committed and hardworking but also has a firm sense of direction. Only then will entrepreneur be able to guide the business unit to its set goals. To ensure that a business unit is running on its set course would require monitoring and evaluation. Regardless of the goals and objectives that a small business may have, it is significant that there is an identification and implementation of the firm's objectives in order to make financial management of firms relevant. Effective financial management strategy is crucial to the growth of micro and small enterprises.

4.3.1. Record Keeping Practice

One of the determinants of success and profitability of micro and small enterprises is financial and related records keeping practice. A regular and organized record keeping practice enables MSEs to calculate risk associated with production, marketing, and sales/income, while in practice they have no proper record practices applied in the MSEs'

Accordingly, 27% of the respondents confirm that recording is made daily, 9% said weekly, also 9% said they made record monthly. Moreover, 2% of the respondents reported that recording practice is takes place annually, 14% of them also confirmed that recording is made irregularly which means it doesn't have fixed period of time. Apart from this, majority (37%) of the respondents confirm that no recording activity was made and the rest 2% doesn't state anything about the recording system (table 4.9).

Table 4.9 Analysis of record keeping practice

No	Time	Frequency	Percent
1	Daily	27	27%
2	Weekly	9	9%
3	Monthly	9	9%
4	Annually	2	2%
5	Irregularly	14	14%
6	Never record	37	37%
7	Not stated	2	2%
	Total	100	100%

Source: own survey

Furthermore, the analysis indicates on table 4.9 indicates that MSEs didn't records their financial transaction properly and timely based; this may create high difficulties to make financial analysis in order to measure the financial performance and growth of MSEs properly.

4.3.2. Bank Accounts

During the field visit it was observed that employees and managers of the Kirkos MSEs understand the advantage of opening bank accounts at least in principle in their business. They explain on their open questionnaires having bank account is often raised along with record keeping practice as one among financial management practices, particularly among the poor, where the culture of saving is likely to be minimal.

Having a bank account is usually believed to have some capacity of enhancing saving culture and discouraging unplanned disbursement. Furthermore, having separate bank account from personal accounts enables owners/managers to know the amount and nature of cash flow of the enterprises. Accordingly, the analysis on Possession of bank account revealed that 51% of the sample micro and small scale enterprises have bank account while 42% do not have bank account at all which is a significant proportion. The analysis indicate almost half of the respondent didn't have bank account this implies if the enterprises didn't have a saving account it is difficult for further financial analysis as well to make increment on the capital of the enterprises (table 4.10).

Table 4.10 Possession of bank account by MSEs

No	Type of business	Frequency Response				Total
		No	Yes	Not stated	Do not know	
1	Textile garment	10	13	1	1	25
2	Food and processing	21	24	2	1	48
3	wood and metal work	11	14	2	0	27
	Total	42	51	5	2	100
	Percent	42%	51%	5%	2%	100%

Source: own survey

CHAPTER FIVE: CONCLUSION AND RECOMMENDATION

5.1. Conclusions

The objective of the study was to assess factors that are mostly affecting the performance of MSEs in Kirkos sub-city of Addis Ababa. This includes examine the sources of finance or funds available for the start-up and the expansion of them. In addition to this, the researchers investigate the contextual factors that affect the financial performance of MSEs and finally recommend possible solutions to alleviate the problem of MSEs.

The study reveals that most of the start-up capital of MSEs were sourced from personal savings, Equb/Idir and family to fund their business, whereas MSEs have no significant access to bank loan. Therefore, MSEs financing their business has been becomes a principal challenge. More over banks do not provide finance in the form of loan to MSE's due to collateral obligations and other requirements. Evidentially 78% of MSEs have not received any credit service in the sub city.

Operations of MSEs particularly metal and wood work are land intensive activities and their performance highly depend on the availability of land. The MSEs are not getting the required land because of lack of awareness from the officials' side and scarcity of the land in their sub city as a result around 28% of those MSEs have received land from the government for their operations.

Lack of adequate marketing channels and lack of marketing skills are the problems to starting the business, Effective financial management strategy is crucial to the growth of micro and small enterprises more impotently they have no proper record practices applied in the MSEs as a result the researcher unable to measure the performance of them.

majority (37%) of the respondents confirm that no recording activity was made this may be a serious problem for the enterprises and the rest 2% doesn't state anything about the recording system Lastly analysis on Possession of bank account revealed that 51% of the sample micro and small scale enterprises have bank account while 42% do not have bank account at all which is a significant proportion.

5.2.Recommendations

There are several important implications in providing adequate assistances to the MSEs sector, basically, for it enhances competition which has been proved to be the engine of multi-faceted change in the economy. In addition, providing necessary policy support to the sector will be the stepping stone for the creations of thousands of entrepreneurs who are, in turn, willing and daring to take necessary risk to change their lives and thus the country for the better. With this background, hence, this study proposes the following measures to address the problems facing the MSEs to enhance the best practices the MSEs demonstrated so far.

- Government officials should give priority to provide land for wood and metal works and garment and textile sectors of MSEs.
- MSEs should be aware on preparing proper financial records and practices in order to know their status. That means improving business management skills like record keeping and practices.
- Banks should be entertain and provide loan access to MSEs to foster and to play their role in developmental activities in the country.
- Policies Makers extended their follow up for bringing changes to the lives of many MSEs.
- MSEs should prepared themselves to tackle the problems hindered to their growth by Enhancing linkage among MSE ,Continue to work on formalization, strive to Strengthen the provision of credit, and Improving or maintaining administrative efficiency.

REFERENCE

- Adil, Yassin, (2007). Challenges and constraints of Micro and small scale enterprises. In Addis Ababa: The case of 2 sub-cities' Industrial Zones. MA thesis in Regional and Local Dev't Studies, RLDS, Addis Ababa University.
- Admissive, A. & Matambalya, F.T. (2002). Technical efficiency of Small and Medium-Scale Enterprises: Evidence from a survey of Enterprises in Tanzania. *Eastern Africa Social Science Research Review* 18, 1-29.
- Agyapong, D. (2010). Micro, small and Medium Enterprises' Activities, Income. Level and Poverty Reduction in Ghana-A Synthesis of Related Literature. *International Journal of Business and Management*, 5(3): 196-205.
- Aggre, N, - Ochai, M. & Mukasa I. (2012). The effects of investment climate on manufacturing firm growth in Uganda. ICBE-RF research report No. 19/12. Makerese University, elgand.
- Ahmad, S. Z., N. S. A. Rani and S. K. M. Kassim. (2011). *Business Challenges and Strategies for Development of Small and Medium Sized Enterprises (SMEs) in Malaysia*. *Int. J. Business Competition and Growth*, 1(2): 177-197.
- Anderson, Dennis, and Carrier L. (1994). Small Industry in Developing Countries: Some Issues. World Bank Staff King Paper 518. Washington, D.C.
- Basis Project Team. (2008). *The Basis Project Financial Management online toolkit*. Retrieved from. Inspiredindividuals.org/wpcontent/.../Financial-Management-toolkit.pdf
- Carrier, C., (2008). Entrepreneurship in Large Firms and SMEs: A Comparative study, *International Small business Journal*, 12(3): 11-23.
- Danniel Woldekidan Elfeta. (2007). Micro and small Scale Enterprises and their influences in Alleviating urban Poverty in Nekemte City, Oromiya Regional state. MA thesis in Regional and Local Development studies: RLDS, Addis Ababa University.
- Dwivedi, D. N. (2005). *Macroeconomics theory and policy* (2nd ed.). New Delhi: Tata McGraw-Hill Publishing
- Enock Nkonoki. (2010). what are the factors Limiting the success and/or growth of small Businesses in Tanzania?-An empirical study on small business growth: Arcada University of Applied Sciences, Tanzania.

- Griffin, R. W., & Ebert, R. J. (2006). *Business* (8th edition). New Jersey: Pearson Prentice- Hall
- International Labor Organization (ILO). (2008). Profile of Employment and Poverty in Africa. Report on Ethiopia, Nigeria, Ghana, Tanzania, Kenya, and Uganda. East Africa Multi-disciplinary Advisory Team (EAMAT). Geneva, ILO Publications.
- Liedholm C, MacPherson M and Chuta E (1994) Small Enterprise Employment Growth in Rural Africa, *American Journal of Agricultural Economics*, Vol. 76, 10-15.
- ILO (2002), '*Employment, Incomes and Equality: A Strategy of Increasing Productive Employment in Kenya*'. Geneva: International Labor Organization.
- ILO (International labor organization), 2006. Vulnerability and young women entrepreneurs: the case study of Ethiopian informal economy, Geneva, international labor organization.
- Longenecker, J. G. et al. (1997). *Successful small business management*. Ohio: West College Publishing.
- Manual Werotew Bezbih Assefa. (2010): Entrepreneurship: An Engine for Sustainable Growth, Development, Prosperity and Governance; Genius Training and consultancy service, Addis Ababa, Ethiopia.
- Mulhern D. (1995). Entrepreneurship and management. *Journal of small Business Management*, 25(3):92.
- Republic of Kenya, (2008) Economic Survey. Nairobi Kenya: Government Printers, 2008
- Scarborough, N. M., & Zimmerer, T. W. (2008). *Essentials of entrepreneurship and small business management* (5th ed.). New Jersey: Prentice Hall.
- Sievers H. & Vandenberg G. (2007). Gender, poverty and Micro enterprise services in Ethiopia: Why only few women are joining? Women Development Initiative Program.
- Simeon Nichter and Lara Goldmark. (2009). Small Firm Growth in Developing countries. *World Development*, 37(9): 1453-1464.
- Siyoum, G. (2012). Business Costarints and growth potential of Micro and small enterprises. Evidence from Holeta Town (Master thesis) Mekelle Unviersity, Ethiopia.
- Susman, G. I. (2007). *Small and medium size enterprises and the global economy*. U.K: Edward Elgar Publishing
- Tegegne Gebre-Egziabher & Meheret Ayenew (2010). Micro and Small Enterprises as vehicles for poverty Reduction, Employment creation and Business Development: the Ethiopian Experience. Forum for social studies, Research Report No. 6, Addis Ababa, Ethiopia

- Tootelin, C. E., & Gaedeke, R. M. (2002). *Small business management* (2nd ed.). New York: Mc Graw-Hill.
- Tushabonwe - Kazooba, C. (2006). Causes of Small Business Failure in Uganda: A Case Study from Bushenyi and Mbarara Towns. *African Studies Quarterly*, 8(4) Retrieved from <http://web.Africa.ufl.edu/jasq/v8/v8i4a3.htm>.
- Tushabomwe, C. K. (2006). Causes of Small Businesses failure in Uganda: A case study from Bushenyi and Mbarara Towns. Tanzania.
- United Nations Industrial Development organization (UNIDO). (2002). Rural Enterprise Development Support Project: Entrepreneurial skills for group based SMEs. Trainers
- Wolfenson, J. D. (2007). 'The challenges of Globalization: the role of the world bank. Paper presented at the address to the Bundestag Berlin, Germany.
- Zelege Worku. (2009). Efficiency in Management as a Determinant of Long-term Survival in Micro, Small and Medium enterprises in Ethiopia. *Problems and Perspectives in Management*, 7(3):1-9.

APPENDICES

Appendix – 1: Questionnaire for Primary Data Collection

This questionnaire is designed to collect data from both micro and small business operators in Addis Ababa: the case of enterprises in Kirkos sub cities. Your cooperation in providing genuine answers to the following questions is highly important for the success of this study. Your responses will be kept confidential. It is only for academic purpose. Thank you for your cooperation!

Part One: General Information

1. Age: A. 18-30 B. 31-45 C. 46-55 D. 51-60 E. Above 60 years
2. Sex: A. Male B. Female
3. Marital status: A. Unmarried B. Married
4. What is your educational level?
 - A. Does not read and write
 2. Read and write
 - B. Elementary School.
 - C. Secondary School
 - D. TVET graduate
 - E. College diploma
 - F. First degree and above
5. What is the nature of your business? 1. Proprietorship 2. Partnership
6. What is the main activities of the enterprise
 - A. Textile and garment
 - B. Food processing
 - C. Wood and metal work
7. What are factors motivated you to involve in this business? (More than one answer is possible)
 - A. Profitability of the business
 - B. Lack of employment alternatives
 - C. Good government support
 - D. Previous experience
8. Did you have an employment before you join this business?
 - A. Yes
 - B. No

Part Two: Basic Business Information

1. How do you see the favorability of the business environment for MSEs?
 - A. Very good
 - B. Good
 - C. Medium
 - D. Low
 - E. very low
2. What is your source of capital to start your business?
 - A. Banks
 - B. Family and relatives
 - C. Microfinance institution
 - D. Iqub/Idire
 - E. Personal saving
 - F. NGOs
3. Which are the most important business constraints that hindered your enterprise expansion?
 - A. Access to loan
 - B. Access to land
 - C. Access to marketing
 - D. Other specify
4. How do you evaluate the service provided from the kirkos administration bodies?
 - A. Very helpful
 - B. Helpful
 - C. Useless
5. Have you obtained bank loan from any Micro financial institutions?
 - A. Yes
 - B. No
 - C. If your answer is no what is the reason? _____
6. Do you have enough work place to your operation/business?
 - A. Yes
 - B. No

- C. If you say no write short no of reason_____
7. Do you obtain market information and availability to sell your product
- A. Yes
 - B. No
8. When do you record your business transaction
- A. Daily
 - B. Weekly
 - C. Monthly
 - D. Annually
 - E. Never record
 - F. Irregularly
9. Do you keeping the following book accounts?
- A. Sales book A. yes B. No
 - B. Purchasing book A. Yes B. No
 - C. Expense book A. Yes B. No
 - D. Cash book A. Yes B. No
 - E. Other books _____
10. Do you have bank accounts in commercial in any micro financial institutions/banks
- A. Yes
 - B. No
11. Please say something about MSEs challenges and opportunities or any comment related to this?
-
-
-

Project Proposal

On

Factors affecting the financial performance of Micro and Small

Enterprises in kirkos

Sub- city, Addis Ababa

By:- Mehari W/Aregay

(089133830)

Submitted to the coordinator (project), school of management

studies Indira Gandhi National Open University (IGNOU),

Maidan Garhi, New Delhi-110068

In partial fulfillment of the requirements for Master of Business

Administration (MBA)

In Finance

Advisor:

DEREJE GELANA HALITEW

Addis Ababa University

November , 2015

TABLE OF CONTENT

Content	Page
1. Introduction.....	1
2. Statement of the Problem.....	4
3. Significant of Study.....	5
4. Objectives of the Study.....	6
4.1. General Objective.....	6
4.2. Specific Objectives	6
4.3. Research Hypothesis	6
5. Research Methodologies.....	8
5.1. Research Design.....	8
5.2. Data Collection.....	8
5.3. Sampling Strategy and Procedures	9
5.4. Sampling Technique.....	10
5.5. Data Analysis.....	10
6. Organization of the study.....	11
7. Limitations and Delimitation of the Study	11
7.1. Limitations of the Study	11
7.2. Delimitation (Scope) of the Study	11
8. Time and Resource Management.....	12
9. Reference.....	13

1. Introduction

The micro and small business sector is recognized as integral component of economic development and a crucial element in the effort to lift countries out of poverty (WOLFenson, 2007:28-39).The dynamic role of micro and small enterprises (MSEs) in development countries as engines through which the growth objectives of developing countries can be achieved has been recognized. It is estimated that MSEs employ 22% of the adult population development countries (Fisseha. 2006:43).

In developing countries, 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. The MSEs sector has also been instrumental in bringing about transition by providing goods and services, which are of adequate quality and are reasonably priced, to a large number of people, and by effectively using the skills and talents of a large number of people without requiring high-level training, large sums of capital or sophisticated technology (ILO, 2008:56). Similarly, Lara and Simeon (2009:1453-1464) found that the MSE sector generate substantial employment and economic output in many countries. Their share of overall employment tends to be higher in developing countries, which are typically more focused on small-scale production.

The sector has potential to provide ideal Environment for enabling entrepreneurs to optimal exercise their talents and to attain their personal and professional goals (MoTI, 1997:9). In all successful economies, MSEs are seen as an essential springboard for growth, job creation and social progress. The small business sector is also seen as an important force to generate employment and more equitable income distribution, activate competition, exploit niche markets, and enhance productivity and technical change and, through the combination of all of these measures, to stimulate economic development. This is not denying the importance of large industries and other

enterprises for the growth of the Ethiopian economy, there is ample evidence to suggest that the labor absorptive capacity of the MSE sector is high. The average capital cost per job created is usually lower than in big business, and its role in technical and other innovative is vital for many of the challenges facing Ethiopia (MoTI, 1997:9).

In Ethiopia, MSEs sector is the second largest employment-generating sector following agriculture (CSA, 2005:34-35) .A national survey conducted by Ethiopian central statistical authority (CSA) in 2005 in 48 major towns indicates that nearly 585,000 and 3,000 operators engaged in micro and small scale manufacturing industries respectively, which absorb about 740,000 labor forces. Accordingly, the whole labor force engaged in the micro enterprises and small scale manufacturing industries is more than eight folds (740,000 persons) to that of the medium and large scale manufacturing industries (90,000 persons). This is a contribution of 3.4% to GDP, 33% of the industries sector's contribution and 52% of the manufacturing sector's contribution to GDP of the year 2001(CSA, 2005:34-35).

According to Mulhern (1995:2-92), MSEs exert a strong influence on the economies of all countries, particularly in the developing countries. He reported that the MSEs have been a major engine in the economic growth, innovation and technological progress. In addition carrier (2008: 11-23) stated that:

The MSEs are more fertile than their larger (enterprises) in terms of innovation and development. The MSE sector is characterized by highly diversified activities which can create job opportunities for a substantial segment of the population. This indicates that the sector is a quick remedy for unemployment problem. To curb unemployment and facilitate the environment for new job seeker and self-employment a direct intervention and support of the government is crucial.

Assistance and support to strengthen these enterprises can lead to higher profits and employment levels which in turn can contribute to a bottom-up transition out of poverty for entrepreneurs and workers (Sievers & Vandenberg, 2007:1341). It is further believed that:

The MSE activities can contribute to increasing tax-incomes for the Government and enable the government in the long run to invest the money. In order to strengthen the position of MSEs, the access to financial and non-financial services plays a pivotal role in the performance and expansion of these enterprises. The strengthening and the expansion of existing MSEs and the support of new enterprises can contribute to fulfill social objectives, attract considerable foreign reserves into a country and have a clear importance in providing employment, meaning they are the backbone of the private sectors in developing countries (Mead & Liedholm).

The aim of MSE development and the provision of MSE services are to enable the entrepreneurs to take advantage of market opportunities and improve the access to skill development opportunities that strengthen entrepreneurial capabilities (UNIDO, 2002:36).

Micro and small enterprise in Ethiopia are, however, confronted with several factors that affect the performance of MSE. The major factors include financial problems, lack of qualified employees; lack of proper financial records, marketing problems and lack of work premises, etc. besides, environmental factors affects the business which includes social, economic, cultural, political, legal and technological factors. In addition there are also personal attitudes or internal factors that affect the performance of MSE, which are related to the person's individual attitude, training and technical know-how (Werotew, 2010: 226-37). Generally, there are external (contextual) and internal factors which are still affecting the financial performance of MSEs.

2. Statement Of The Problem

In most developing countries, MSEs face constraints both at start up phases and after their establishment. The study conducted by Ethiopian CSA disclose that, the contribution of small enterprises in creating job opportunities and in the development of our economy is vital (FMSEDA, 2006:13). However, their contribution is very low in compared with that of other countries due to financial problem, lack of qualified employees, lack of proper financial records, marketing problems, lack of working premises and raw materials. Lack of information about market opportunities and standards and regulation is one of the underlying factors that hinder their performance (Mulu Gebreeyesus, 2009:10-13).

In Addis Ababa, MSEs have a problem of finance when establishing the business. Most individuals sources of finance come from personal savings and loans acquired from relatives, friends and moneylenders with high amount of interest (MoTI, 2005:13-14). After the business goes operational, the probability of becoming profitable and paying back debts along with accrued interest is less.

To address above constraints, this study aims to provide a holistic view of factors affecting the financial performance of MSEs through a comprehensive review of literature and empirical study available on the area. In view of the problems, the central question of this study is:

- What are the factors that mostly affect the financial performance of MSEs in kirkos sub-city? Specifically, the following sub-questions are raised:
- What are the sources of finance or funds available to the MSEs?
- What are the various contextual factors that impeded the financial performance of MSEs?
- What are the external factors that affect the growth of MSEs?

- How can be the problems of MSEs in Kirkos sub-city minimized?

The rationale for selecting this study is based on an appreciation that the findings of study which aims to create meaningful results on the economic development and help reduce poverty. Micro and small enterprises in Ethiopia provide goods and services in promoting innovation and enhancing the enterprise culture, which is necessary for private sector development and industrialization. This study with its stakeholders as owner managers would use the research findings to predict the success or failure of the businesses, based on the orientations prevalent, and therefore choose what would be best outfit for their practice.

3. Significant Of Study

The findings of the study will be useful to the stakeholders including:

1. Academics/Researchers

Findings from the study will assist academicians in broadening of the prospectus with respect to this study hence providing a deeper understanding of the critical factors that affect the performance of MSEs.

2. Micro And Small Enterprises

The findings of this study will help MSEs in Kirkos sub-city and others, within an insight into the benefits of using different factors studied in this research to predict the factors that affect the performance of MSEs.

3. Governmental Policy Makers

The government can use the findings of this study to assist in policy formulation and development for a framework for critical finance, marketing, work premises and other factors that affect the performance of MSEs.

Moreover, the findings of this study will help the policy makers and financial institutions how to encourage establishing or expanding MSEs. It also enables them to know what kind(s) of should be framed.

4. Objectives of the Study

4.1. General Objective

The main objective of the study is to assess factors that are mostly affecting the performance of MSEs in Kirkos sub-city of Addis Ababa.

4.2. Specific Objectives

The Specific Objectives Are:

- Examine the sources of finance or funds available for the start-up and the expansion of MSEs.
- To identify financial tools currently used by MSEs in measuring their financial performance
- Investigate the contextual factors that affect the financial performance of MSEs.
- Assess the internal factors that affect the performance of MSEs.
- Recommend possible solutions to alleviate the problem of MSEs.

4.3. Research Hypothesis

With the help of sufficient and appropriate empirical data on the factors affecting the performance of MSEs, this study will test the following hypothesis:

Access to Credit

It is defined as access of its credit formal financial sources. When the firm wants to expand their business, it needs capital either from in its own internal (own saving) or external sources (debt). According to Aggrey, Ochai, and

Mukasa (2012), access to credit is negatively associated with the firm growth. The enterprises with limited debt financing growth potential are lower than those enterprises having access debt financing. Therefore limited access to debt financing is negatively affecting financial stability of MSEs (Siyoum, 2012). Eshetu and Zeleke (2008) also found that absence of loan formal financial institution for investment is the major factor affecting long term survival of MSEs in Ethiopia. Although financial issues are essential to all firms, 75% of Micro enterprise and 72% of small enterprises failed due to lack of finance. These the hypothesis for this factor is as follows:

Ha 1: MSEs that have access to credit from formal financial sources are more financial stable as compared to those that have not.

Access to Working Premises:

MSEs, that have won premise is positively associated with its growth. Any business enterprises need enough working and marketing place for their product and services. Unless having enough working and selling place, the productivity of MSEs go down due to the fact that the product produced need warehouse to store and selling outlets to rich in the hands of final customers which is major determinant for existence and growth of the enterprises. Therefore, those enterprises having enough working premises grow more than those enter prices which have not working premises and selling outlets.

(Siyoum, 2012). The empirical study of (Solomon, 2004) showed that MSEs operators that secure own working place and buildings are in a better position to plan with greater certainty and stand a better chance of accessing the needed infrastructure and in doing so well enhance the growth of such enterprises. Thus, the hypothesis for this factor is as follows.

Ha 2: MSEs that have own working premises and business plan are more likely to grow faster as compared to others.

Access to Infrastructure

Growth of firms is also enhanced by the availability of infrastructure inputs such as water, electric light, road network etc. MSEs which have access to sufficient infrastructural facilities grow by 51.9% rate of employment than those which have not (Solomon, 2004). On the other hand, Aggrey et al. (2012) reported that access to infrastructure has no significant effect on the profitability of the firm. Thus, the hypothesis for this factor is as follows.

Ha 3: MSEs that have sufficient access to infrastructure are likely to profitable more than those that have not supportive access to infrastructure.

5. Research Methodologies

5.1. Research Design

This research employed descriptive and explanatory research. This study describes and critically assesses the factors affecting the financial performance of MSEs in kirkos sub-city Of Addis Ababa. Second, the study use explanatory in that the relationship between variables is correlated with an aim of estimating the integrated influence of the factors on performance. In addition the study utilized cross-sectional in the sense of that all relevant data was collected at a single point in time. The reason for preferring a cross-sectional study is due to the vast nature of the study and limitation of time.

5.2. Data Collection

The study employed both primary and secondary sources of data collection.

Primary Sources

In order to realize the target, the study used well-designed questionnaire as best instrument. This was completed by the owner managers/ or operators of the enterprises. Besides, face-to-face interviews with the MSEs operators/and the relevant owner managers who heads the enterprises in the food processing, textile and garment and wood and metal work sectors.

Secondary Sources

These data collect from files, financial records and report, pamphlets, office manuals, circulars and policy papers were used to provide additional information where appropriate. Besides, variety of books, published and/or unpublished government documents, websites, reports and newsletters will be reviewed to make the study fruitful.

5.3. Sampling Strategy and Procedures

The Kirkos sub-city is purposely choose among the ten sub-city of Addis Ababa, as a study area for this thesis. This is because it is nearness and convenience to collect the data in short time. And this study is selected textile and garment, food processing, metal and wood work sectors because of the following rationales.

First, the sector are selected because of largest concentration in number compared to other sectors the sub-city.

Second, it is difficult to reach the operators/or owners managers of some sectors like municipality service parking and others.

Lastly, textile and garment, metal and wood work 'popularity' in Ethiopia by absorbing significant number of operators via cooperative form of organization is also shown empirically by Meheret and Tegegne (2010:36-370).

5.4. Sampling Technique

Stratified random sampling is used to get information from different sizes of the MSEs. This technique is preferred because it is used to assist in minimizing bias when dealing with the population. With this technique, the sampling frame will be organized in to relatively homogenous group (strata) before selecting elements for the sample. According Janet (2006:94), this step increases the probability that the final sample will be representative in terms of the stratified groups. The strata's are sectors including textile and garment, food processing and wood and metal works.

The population of this study covers all formally registered MSEs in the category of textile and garment, food processing and wood and metal works until June 2015 by Kirkos sub city administration trade and MSEs development agency Bureau. A total of 125 respondents will be selected from textile and garment, food processing and wood and metal works on proportional basis. The sample size select here is considered are representative of the sectors and also large enough to allow for precision, confidence of research findings.

5.5. Data Analysis

This is the further transformation of the processed data to look for patterns and relationship between and/ or among data groups by using descriptive and inferential (statistical) analysis. The collected data will be analyzed using the statistical package social science (SPSS) version 20. Logical analysis will be used to describe the findings of the data. In addition, appropriate tables and

figures will be used to present the data. The findings of the study will be presented in a manner that meets the purpose of the study.

6. Organization of the study

The paper is organized as follows: Chapter one introduction, Chapter two presents the theoretical and Literature Review, chapter three provides research methodology, chapter four outlines data presentation, analysis and interpretation and chapter five conclusions and suggests some recommendations.

7. Limitations and Delimitation of the Study

7.1. Limitations of the Study

Like all research, this study had limitations. The sources of difficulties encountered in this study are described as follows: most of the documents that are concerned with micro enterprises are written in Amharic. To translate in to the required instruction language (English) takes longer period. Another problem encountered in this study has to do with the operator's reluctance to cooperate due to suspicion that disclosing information may lead to negative effect on their business. It is very important to note that these limitations did have significant interference with the outcome of the study.

7.2. Delimitation (Scope) of the Study

The study assessed factors affecting the performance of MSEs in Addis Ababa city particularly in Kirkos sub-city. Although, there are different issues that can be researched in relation to MSEs, this study is delimited to the Political-legal, working premises, technological, infrastructural, marketing, financial, management and entrepreneurial factors. Besides, the scope of this study was spread across MSEs especially in the business sector of textile and garment, food processing and metal and wood work sectors.

8. Time and Resource Management

This thesis is conducted within time frame of months divided into three phases. First, carry out literature review, second questionnaire distribution and data collection and finally data analysis and presentation of preliminary results within the total estimated budget of Br.10, 000.

Table 1: Estimated cost breaks down

S/n	Type of cost	Amount
1	Transportation	6,756
2	Bedroom	1,000
3	Stationeries	1,244
4	Different daily consumption	1,000
	Total	10,000

Table 2: Time frame of the thesis mission during 2015-2016

S/n	Description	Month
1	Preparatory work	Nov/2015
2	Carryout literature review	DEC/2015
3	Questionnaire distribution and data collection	Jan/2016
4	Data Analysis and presentation of preliminary result	Feb/2016

9. Reference

- ✚ Adil Yassin.(2007).challenges and constraints of Micro and small scale enterprises. In Addis Ababa: The case of 2 sub-cities' Industrial Zones.MA thesis in Regional and Local Development studies, RLDS, Addis Ababa University.
- ✚ Admassie, A. & Matambalya,F.T.(2002).Technical efficiency of Small-and Medium- Scale Enterprises: Evidence from a survey of Enterprises In Tanzania. Eastern Africa Social Science Research Review 18, 1-29.
- ✚ Agyapong, D. (2010). Micro, small and Medium Enterprises' Activities, Income. Level and Poverty Reduction in Ghana-A Synthesis of Related Literature. International Journal of Business and Management, 5(3): 196-205.
- ✚ Anderson, Dennis, and Carrier L. (1994). Small Industry in Developing Countries: Some Issues. World Bank Staff King Paper 518. Washington, D.C.
- ✚ Carrier, C., (2008). Entrepreneurship in Large Firms and SMEs: A Comparative study, International Small business Journal, 12(3): 11-23.
- ✚ Danniell Woldekidan Elfeta. (2007). Micro and small Scale Enterprises and their influences in Alleviating urban Poverty in Nekemte City, Oromiya Regional state. MA thesis in Regional and Local Development studies: RLDS, Addis Ababa University.
- ✚ Enock Nkonoki. (2010). what are the factors Limiting the success and/or growth of small Businesses in Tanzania?-An empirical study on small business growth: Arcada University of Applied Sciences, Tanzania.
- ✚ International Labour Organization (ILO). (2008). Profile of Employment and Poverty in Africa. Report on Ethiopia, Nigeria,Ghana, Tanzania, Kenya, and Uganda. East Africa Multi-disciplinary Advisory Team (EAMAT). Geneva, ILO Publications.
- ✚ Simeon Nichter and Lara Goldmark. (2009). Small Firm Growth in Developing countries. World Development, 37(9): 1453-1464.

- ✚ Mulhern D. (1995). Entrepreneurship and management. *Journal of small Business Management*, 25(3):92. Sievers H. & Vandenberg G. (2007). Gender, poverty and Micro enterprise services in Ethiopia: Why only few women are joining? Women Development Initiative Programme.
- ✚ Tegegne Gebre-Egziabher & Meheret Ayenew (2010). Micro and Small Enterprises as vehicles for poverty Reduction, Employment creation and Business Development: the Ethiopian Experience. Forum for social studies, Research Report No. 6, Addis Ababa, Ethiopia
- ✚ United Nations Industrial Development organization (UNIDO). (2002). Rural Enterprise Development Support Project: Entrepreneurial skills for group based SMEs. Trainers Manual Werotew Bezbih Assefa. (2010): Entrepreneurship: An Engine for Sustainable Growth, Development, Prosperity and Governance; Genius Training and consultancy service, Addis Ababa, Ethiopia.
- ✚ Wolfenson, J. D. (2007). 'The challenges of Globalization: the role of the world bank. Paper presented at the address to the Bundestag Berlin, Germany.
- ✚ Siyoum, G. (2012). Business Costarints and growth potential of Micro and small entepriises. Evidence from Holeta Town (Master thesis) Mekelle Unviersity, Ethiopia.
- ✚ Aggre, N, - Ochai, M. & Mukasa I. (2012). The effects of investment climate on manufacturing firm growth in Uganda. ICBE-RF research report No. 19/12. Makerese University, elgand.