



**ST. MARY'S UNIVERSITY  
SCHOOL OF GRADUATE STUDIES**

**DETERMINANT OF ACCESS TO FORMAL FINANCE  
IN SMALL AND MEDIUM MANUFACTURING  
ENTERPRISES' IN ADDIS ABABA ADMINISTRATIVE  
CITY**

**BY  
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**JUNE, 2016  
ADDIS ABABA, ETHIOPIA**

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**June, 2016**

**ADDIS ABABA, ETHIOPIA**

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## **DECLARATION**

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Zinegnaw Abiy (PhD). All sources of material used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institutions for the purpose of earning any degree.

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**June, 2016**

## **ENDORSEMENT**

This thesis has been submitted to St. Mary's University, School of Business for examination with my approval as a university advisor.

Zinegnaw Abiy (PhD)

Advisor

**St. Mary's University, Addis Ababa**

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Signature

**June, 2016**

## **DEDICATION**

This work is dedicated to all members of my family including my uncle Ato Adem Seid Emeru and HHM who have been encouraging not only to start studying my second degree but also for their prayer and continuous encouragement throughout my life.

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## **LIST OF ACRONYMS**

MSE's	Micro and Small Enterprise's
SME's	Small and Medium Enterprise's
SMME's	Small and Medium Manufacturing Enterprise's
SMMIA	Small and Medium Manufacturing Industry Agency

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## ABSTRACT

*Access to formal finance is fundamental and still remains a challenge for the growth and survival of SME's. Especially it is challenging for those developing countries in Sub-Saharan African countries including Ethiopia. Thus, the purpose of this study is to investigate what factors explain Small and Medium Scale Manufacturing Enterprise's access to formal finance in Addis Ababa administrative city. Although the financial determining variables in obtaining formal finance are studied by different researchers around the world and locally studied by few researchers in different regions outside of the capital city Addis Ababa, no study has been conducted on the matter and no solution on these obstacles have been recommended in Addis Ababa. The study is designed as explanatory and employed the quantitative approach, in which stratified sampling was employed to select 180 small and medium scale manufacturing enterprises from the overall enterprises in Addis Ababa. In order to find out major determinants the study use Statistical Package for Social Science version 20 to run Binary Logistic Regression Model. The major findings of the study shows that there exist significantly, positive relation between certain attributes of a firm and owner-manager including; educational level of owner-manager, bank relation with credit provider and age of owner manager. The findings of this study will be beneficial for SMMEs to overcome their drawbacks concerning their highest educational level and intimacy with bank. However, this study is limited to the demand side factors only and future researches recommended to study including the supply side at national level.*

**Keywords:** *Access to Finance, Formal Finance, Small and Medium Enterprises*

# CHAPTER ONE

## 1.1 Background of the Study

Access to finance is very crucial for SME's growth and expansion just like an engine for vehicles. According to the result found by Czemieli (2013) access to finance is indispensable for the efficient allocation of capital and the enterprise's development. However, if they couldn't find the financing they need innovations and brilliant ideas may fall down and this represents a loss in potential growth for the economy (Belanova, 2013). The most important is SME's face different challenges in seeking financial resources from formal financial institutions.

The growth and development of SME's in a country plays a great role and can contribute to poverty reduction (Green, Kirkpatrick, and Murinde, 2006). One of the possible ways put forward by Green et al. (2006) in reduction of poverty is improving the supply of financial services to the poor. Likewise Beck and Demingue (2006) summarized recent empirical research articles related to access to finance as a growth constraint and finally conclude that access to finance is an important growth constraint for SME's and suggest that legal institutions play an important role in relaxing this constraint.

SME's face difficulties when they are seeking to obtain the necessary funding resources related with both entrepreneurial characteristics and firm characteristics (Czemieli, 2013). For instance worldwide literature on the subject of access to finance shows that firms report access to finance as a major obstacle to development and growth for SME's next to inflation, taxes and regulation and political instability (Brehanu & Mesfin, 2015; Green et al., 2006.; Kofi, Paul, and Gaeten, 2013; Beck & Cull, 2014; Czemieli, 2013; Belanova, 2013; and Beck & Demingue, 2006).. Besides, Belanova (2013) shows that even if SME's are in a growth phase refusal of bank loan application is practical due to lack of collateral.

In terms of risk, SME's are generally considered as riskier than large firms due to their nature of lower survival rate, large variance of profitability and growth (Nguyen & Luu, 2013). As a result SME's suffer from higher interest rate. Another finding by Kofi et al. (2013) in terms of risk, they found that service sector is most favored than those in the production and agricultural sector due to volatility of the latter sector which leads to loan default.

Almost all countries in Sub-Saharan Africa have experienced a persistent jump in growth rate (especially in terms of GDP growth per capital Fjose, Grunfeld, & Green, 2010). For instance, Angola, Ethiopia and Mozambique display strong growth (Fjose et al., 2010). Whereas, most SME's operating and developing business in Africa considers the most important challenge as access to electricity and finance (Fjose et al. 2010). Surprisingly, enterprises in sub Saharan African region are less likely to have a loan (formal finance) than in other developing region of the world (Beck & Cull, 2014).

The role played by SMEs and micro enterprises in Sub-Saharan Africa Countries for the developing economy and the challenge they faces are often completely different. Micro enterprises often struggle with fluctuating revenues and lack of knowledge and relevant competencies. Similarly SME's are facing many problems like access to sufficient amount of risk capital, access to technology and access to stable electricity supply (Fjose et al., 2010).

In addition to that, behind the growth of firms are individuals with different levels of motivation, education and management skills and it have its own impact on growth, diversification and development of enterprises (Beck & Cull, 2014). As a result, understanding the characteristics of successful entrepreneurs and the effect of social networks and education is important (Beck & Cull, 2014). The study by Green et al. (2006) found that the growth of MSE's is found to be mainly slow down by lack of access to finance among other factors.

There is unresolved issue as far as SME's are concerned which is the problem faced by those enterprises in obtaining financial resources from formal financial institution. For instance, owner characteristics and firm characteristics have very mixed impact on accessibility of formal finance and the result seems to vary across countries. Therefore the major purpose of this study is to find out what factors explains access to finance by SMME's in Addis Ababa region. Even though micro enterprises are not included under the study, it doesn't mean that they are less important while conclusions drawn from SME's can be extended to Micro Enterprises.

## **1.2 Definition of Small and Medium Scale Enterprises**

The definition of small and medium enterprises (SME's) worldwide is different which mean there is no fast and sharp rule to define Small and Medium-sized Enterprises worldwide. Accordingly different countries and institutions define using a number of measures to identify



and describe SME's while there is no consensus on any one measure. The most frequent metrics used to define SMEs are the number of employee of the enterprise, the value of fixed asset of the enterprise and enterprise annual turnover in terms of revenues (Cook and Nixun, 2005; Green et al.; ITC, 2009; WBCSD & SNV, 2007).

In Ethiopia, SMEs are defined based on the capital employed and the number of employees under the enterprise. The name given to these enterprises previously were Micro and Small Enterprises which is administered by Micro and Small Enterprises Development Bureau. At this moment, the recent proclamation of Minister of Council (regulation # 373/2016) sub divides the previous institution in to two as; Urban Job Creation and Food Security Agency and Small and Medium Manufacturing Industry Agency.

The recent regulation, regulation No. 373/2016, states the definition of both Small Manufacturing Industry and Medium Manufacturing Industry as follows. Small Manufacturing Industry means an industry having a total capital, excluding building, Birr 100,001 to Birr 1,500,000 in the manufacturing sector and engages from 6 to 30 workers including the owner, his family members and other employees. Medium Manufacturing Industry means an industry having a total capital, excluding building, from Birr 1,500,001 to Birr 20,000,000 in the manufacturing sector and engages from 31 to 100 workers including the owner, his family members and other employee. Consequently, the operational definition of Small and Medium Manufacturing Enterprises is in line with regulation No. 373/2016.

### **1.3 Statement of the Problem**

Access to formal finance is fundamental and still remains a challenge for the growth and survival of SME's especially in developing countries like Sub-Saharan African countries including Ethiopia (Fjose et al., 2010 and Beck & Cull, 2014). The study undertaken by Beck & Cull (2014) in Sub-Saharan African countries to findout what explains access to finance by SME's in those countries indicates that Small enterprise's are around 30% and Medium scale enterprise's are around 14% less likely to have a formal loan than large firms.

There is a relationship between the ability of SMEs growth and their investment; which mean investments like in restructuring and innovation highly affects their growth. But the question here is where will be the source of the fund for undertaking those investments. The repeated

complain about access to formal credit makes the issue more critical and highly relevant constraint that endanger the economic growth of countries (Kofi et al. 2013).

Although the financial determinants in obtaining formal finance are studied by different researchers (Beck & Cull, 2014; Beck & Demingue, 2006; Belanova, 2013; Czemieli, 2013; Fjose et al., 2010; Green et al., 2006; Hassen & Abdwahab, 2014; Kofi et al., 2013; and Nguyen & Luu, 2013) around the world abroad Ethiopia and locally studied by few researchers (Brehanu & Mesfin, 2015; Brhane, 2014; Gebrehiwot & Wolday, 2006; Selamawit et al., 2014 ) in different regions outside of the capital city Addis Ababa, no comprehensive studies have been conducted on the matter and no solution on these obstacles have been recommended in Addis Ababa.

As per the researcher knowledge, from the overall local researchers studied, few of the researches (Gebrehiwot & Wolday, 2006) in Ethiopia have descriptive nature while most of them are explanatory (Brehanu & Mesfin, 2015; Brhane, 2014; Selamawit et al., 2014 ) and except the study by Gebrehiwot & Wolday (2006), the remaining studies are undertaken out of Addis Ababa. For instance, the study by Brehanu & Mesfin (2015) assess factors affecting access to finance with reference to MSE's in Dilla Town; the study by Brhane (2014) assumed in Debrre Markos town; the study by Selamawit et al., (2014) assess the major determinants of access to finance in general taking a case in Asella town; and the study by Gebrehiwot & Wolday (2006) covered six major towns namely Addis Ababa, Nazret, Awassa, Bahir Dar, Jimma, and mekele while the study is limited to describing rather than explaining the factors contributing for access to formal finance. Therefore, this study have been undertaken to fill the gap, factors affecting access to formal finance, for the region of Addis Ababa using a survey of 180 SMME's operating under the administrative city.

## **1.4 Objective of the Study**

### **General Objective**

The general objective of this study is to find out factors determining Small and Medium Manufacturing Enterprise's access to formal finance in Addis Ababa region.

## **Specific Objective**

For the achievement of the general objective, the study attempts to accomplish the following objectives;

- To explain the influence of age of SMMEs owner-managers towards access to formal finance.
- To examine the influence of SMMEs relationship with credit provider in obtaining formal finance
- To examine the effect of maintaining book of records by SMMEs in obtaining formal finance.
- To examine the effect of attitude of owner-managers in obtaining formal finance.
- To examine the influence of educational level of owner-manager towards access to formal finance by SMMEs.
- To explain the influence of age of SMMEs towards access to formal finance

## **1.5 Definition of Terms**

For the sake of this report, the followings terms are defined as follows;

**Formal Finance:** in this report “formal finance” indicates credits (loan) from formal financial institutions specifically bank and microfinance institutions. Besides, alternatively it can be name as formal credit and formal loan.

**Access to Finance:** For this report “access to finance” has been defined as the degree to which productive SMMEs have access to formal lenders who are able and willing to offer affordable and suitable financing.

**Small Manufacturing Industry’:** the definition of “Small Manufacturing Enterprises” for the sake of this report is as per the recent regulation (regulation No. 373/2016) as an industry having a total capital, excluding building, Birr 100,001 to Birr 1,500,000 in the manufacturing sector and engages from 6 to 30 workers including the owner, his family members and other employees. Besides, alternatively it can be name as Small Manufacturing Enterprises.

**Medium Manufacturing Industry’:** the definition of “Medium Manufacturing Enterprises” for the sake of this report is as per the recent regulation (regulation No. 373/2016) as an industry having a total capital, excluding building, from Birr 1,500,001 to Birr 20,000,000 in the

manufacturing sector and engages from 31 to 100 workers including the owner, his family members and other employee. Besides, alternatively it can be name as Medium Manufacturing Enterprises.

## **1.6 Significance of the Study**

Primarily this study is worth that, this explanatory research will play its part in giving attention to the owner-managers of SMMEs' to overcome both personal and firm level characteristic hold back them from access to formal finance. Secondly, it is important for the Small and Medium Manufacturing Enterprise's Development Agency (SMMEDA) in order to make ease and propose possible ways for the growth and development of SMME's. Thirdly, it is significant for fund providing institutions as well as policymakers in order to revise related policies to make being possible to access loan to SMME's for the growth of the region. Fourthly, the study and frame work designed to explain factors limiting access to formal finance will be expected to serve as an input for future researchers interested in SMMEs study. In addition to that, it helps the researcher to employ theoretical knowledge in to practice.

## **1.7 Scope of the Study**

The study covers only SMMEs operating under the region of Addis Ababa. Besides, the study tries to give explanation about limiting factors to source of finance specific to formal finance and non formal finance is not included and not part of this study. In addition to that, this study focuses only barriers of access to formal finance on the demand side thus; the supply side is not part of the study.

## **1.8 Limitation of the Study**

Obviously any research has its own limitation. Similarly, this study also has its own limitation regarding number of observation employed under the study and source of data used. Concerning sample size determination, the researcher assumes tolerable risk of seven percent and if tolerable risk were five percent the number of observation could be maximized and also the sampling risk will be minimized. So, it can be considered as a limitation for the study. In addition to that, initially the study was designed to incorporate secondary sources of data including financial statements of SMMEs but it was impossible to obtain those data. For that reason, it is another

limitation for the study. In general, the previous limitations in any case didn't reduce significantly the outcome of the study.

## **1.9 Organization of the Study**

This paper is organized in four main chapters; the first chapter is introduction which gives a general aim, coverage, scope and other basic issue of the paper. The second chapter deals with literature review which includes related theoretical and empirical literatures. The third chapter is the methods and methodologies used under the study. The fourth chapter is data analysis and interpretation which analyses data collected from primary data sources. This chapter also presents analysis and interpretation of the findings. The least and most important is chapter five about summary, conclusion and recommendation. In this last chapter conclusion and recommendation regarding the findings of the research presented briefly.

# **CHAPTER TWO**

## **REVIEW OF RELATED LITERATURE**

The literature review has two main parts, theoretical Review and empirical review. But before discussing theoretical issues general overview of SMEs discussed including the importance of Small and Medium Enterprises as well as and why finance will be considered as a constraint. Next to that the related theories and concepts from a broad perspective are discussed. It then deals with more and more specific which focus increasingly on the specific question at hand. In this topic barriers to formal finance discussed under two broad categories; financial institution perspective and SMEs perspective. The first perspective will be part of the theoretical review while barrier to formal finance from SMEs perspective discussed under the empirical review section.

In the second part of the review, the researchers try to summarize previous studies related with access to finance done by both foreign and local researchers; and the third part explains the conceptual framework of the study based on theoretical and empirical reviews. Finally, the literature gap is included at the end of this chapter showing what this study intends to contribute.

### **2.1 Importance of Small and Medium Scale Enterprises**

According to Fjose et al. (2010) many countries in Sub-Saharan Africa have a large number of SMEs relative to the size of the economy. The study reveals that lack of finance and unstable electricity supply are the most several obstacles to SMEs growth and concluded as key obstacle to SMEs entry, investment and growth. As a result empirical evidence shows enterprises in Sub-Saharan African region are less likely to have a loan (formal finance) than in other developing region of the world (Beck & Cull, 2014).

Studies shows the role played by SMEs and micro enterprises in Sub-Saharan Africa Countries for the developing economy and the challenge they faces are often completely different (Fjose et al., 2010). Accordingly, SMEs are facing many problems like access to sufficient amount of risk capital, access to technology and access to stable electricity supply.

The growth and development of SMEs in a country plays a great role and can contribute to poverty reduction (Green et al., 2006) whereas worldwide literature on the subject of access to

finance shows that firms report access to finance as a major obstacle to development and growth next to inflation, taxes and regulation and political instability (Brehanu & Mesfin, 2015; Green et al., 2006; Kofi et al. 2013; Beck & Cull, 2014; Czemiél, 2013; Belanova, 2013; Beck & Demingue, 2006).

On the subject of access to finance Brehanu and Mesfin (2015) found that around 79% of the study participant clearly expresses the major constraint to the growth of their business as lack of finance. Similarly local empirical study results reveal that from a number of obstacles to expand, diversify and growth of MSEs in Debre Markos town the major one is access to finance (Brhane, 2014). Moreover, the growth and development of MSEs in developing countries mainly hold back by access to finance, poor management skills, lack of training opportunities, and high cost of inputs (Green et al., 2006).

SMEs can play a much bigger role in developing national economies, alleviating poverty, participating in the global economy and partnering with larger corporations. Well-managed and healthy SMEs are a source of employment opportunities and wealth creation. They can contribute to social stability and generate tax revenues. SMEs can constitute an important source of local supply and service provision to larger corporations. They usually have extensive local knowledge of resources, supply patterns and purchasing trends. Developing countries also represent a huge, largely untapped market for large corporations. By working closely with SMEs, large corporations can develop a new customer base that may not be accessible to the traditional distribution networks of these corporations (WBCSD & SNV, 2007).

SMEs also represent an important source of innovation. They tend to occupy specialized market “niches” and follow competitive strategies that set them apart from other companies. This might include re-engineering products or services to meet market demands, exploring innovative distribution or sales techniques, or developing new and untapped markets. This often makes them good partners for large corporations (WBCSD & SNV, 2007).

SMEs often have a vested interest in community development. Being local, they draw upon the community for their workforce and rely on it to do business. For the communities, they provide goods and services tailored to local needs and at costs affordable to local people. They are an important source of employment, particularly for low-skilled workers, as well as women and

young people, who usually make up the greatest proportion of the unemployed in emerging economies (WBCSD & SNV, 2007).

## **2.2 Finance: a Key Constraint to SMEs Growth**

The growth of MSEs is found to be mainly impeded lack of access to finance among other factors and one of the possible ways put forward in reduction of poverty is improving the supply of financial services to the poor (Green et al., 2006). Similarly Beck and Demingue (2006) summarized recent empirical research articles related to access to finance as a growth constraint and finally conclude that access to finance is an important growth constraint for SMEs and suggest that legal institutions play an important role in relaxing this constraint.

SMEs require greater access to financial services and investment capital. Large corporations have little difficulty securing sizeable bank loans and private investments. At the same time, microfinance, consisting of very small loans, tends to benefit individual entrepreneurs. SMEs fall in between and often struggle to obtain credit and loans. Some 90% of entrepreneurs in Latin America are obliged to source much of their financing from personal savings and a picture true throughout much of the developing world (WBCSD & SNV, 2007).

According to ITC report (2009), many SMEs consider cost of finance and access to finance as among the major obstacles to growth. This perception is shared in many other developing countries, even at times ranking these two obstacles higher. Studies also show that younger and smaller firms face higher financing obstacles than older and bigger enterprises (Brehanu & Mesfin, 2015; Green et al.; Kofi et al.; Beck & Cull, 2014; Czemieli, 2013; Belanova, 2013; and Beck & Demingue, 2006). Furthermore, these financing obstacles have greater effect on growth of small firms – twice the effect of the same obstacles on the growth of larger firms.

Lack of access to finance is a key constraint on the growth of small and medium enterprises in Sub-Saharan Africa, and thus also an important limitation on employment, economic growth and shared prosperity. African financial systems have improved in the past two decades but still lag behind other developing economies, hampering the positive effects of current record financial inflows (IFC, 2013).



## **2.3 Theoretical Review**

According to ITC report (2009) SMEs in developing and emerging markets are doubly impacted; as financiers tend to retreat from higher-risk markets at the same time as credit shifts further from SMEs and towards larger corporate clients. When banks are extremely risk-averse, small- and medium-sized enterprises (SMEs) are likely to be more affected than larger ones. With banks allowing a lower amount for loans, SMEs, normally among the last in a pecking order, would have even more problems competing for fewer funds at higher costs. Therefore, the theoretical issues related with barriers to formal finance will be addressed and presented in to two sub sections as from the financial institution perspective and SMEs perspective (ITC, 2009; Mishkin & Eakins, 2006; and Howells & Bain, 2007).

### **2.3.1 Barriers to formal finance: financial institution perspective**

What drives the difference in access to finance between small, medium, and large firms? Risk management policies and practices of banks are meant to prevent default and ensure loan repayment. A prudent lender will prefer not to extend loans, even at higher interest rates, if it is unsure of the real costs, the risks or the expected return. Risk and return are positively related: the higher the risk (of lending to a SME, for example), the higher the return that will be demanded by the lender. There is a point, however, where the risk is so high (the probability of repayment so low), that no target return justifies the loan (Mishkin & Eakins, 2006; and ITC 2009).

According to ITC report (2009), many financial institutions are reluctant to look SMEs as a preferred borrower and a few reasons for unwillingness to lend for those enterprises are high transaction costs, imperfect information, high default risk of SMEs, and limited collateral.

#### **2.3.1.1 High transaction cost**

Mainly transaction costs are costs incurred to assess credit, process and monitor loans. Transaction costs are directly related to profitability. The higher the cost of processing a transaction, the lower is the return. The totality of costs, including transaction costs, incurred by banks drives a wedge between the funding cost (deposit rates) and the lending rate banks charge borrowers. The higher these transaction costs, the higher will be the cost of borrowing for businesses. In turn, the higher will be the probability that some set of borrowers will face restrictions on access to funding. The competition for capital within financial services firms

contributes to the cost profit- access dynamic that is so challenging for SMEs (ITC, 2009; Mishkin & Eakins, 2006; and Howells & Bain, 2007).

SME loans are high-cost lending transactions because they are typically small, compared to loans to big firms. Compounding the problem, SME loans are often more time consuming to assess, monitor and manage. Many bankers perceive that small businesses require much more advisory support – handholding – than mid-market or large corporate clients (ITC, 2009).

Small companies often cannot or do not provide lenders with the basic inputs required to facilitate what banks perceive to be an efficient risk assessment process. Audited financial statements, formal business plans or funding proposals, credit reports and verifiable biographies of company executives are inputs to conventional credit assessments that banks often find difficult to gather for SMEs. The diversity and opaqueness of SME businesses further contributes to the view among bankers that SME lending is challenging, risky and generates lower returns than other transactions (Howells & Bain, 2007; and ITC, 2009).

#### **2.3.1.2 Imperfect information**

The lack of public information and credit histories, particularly in countries where credit bureaus do not exist, adds to the difficulty banks have distinguishing SMEs with really good potential from those that only appear so. As a result, banks tend to either reject SMEs with good prospects or put all SMEs in the same lot, charging high interest rates to all, thereby discouraging the good ones. The information asymmetry literature posits that there are two sources of risk: adverse selection and moral hazard. Adverse selection refers to the difficulty of choosing a good borrower, while moral hazard refers to the difficulty of enforcing the agreed credit contract (ITC, 2009).

The risk of adverse selection prevents banks from giving out loans to the highest interest rate bidder and allowing the market to clear that way. Rather, credit rationing takes place accommodating those projects having what are deemed to be the optimal balance between rate of return, and probability of default (Howells & Bain, 2007; and ITC, 2009).

#### **2.3.1.3 High default risk of SMEs**

Bank outreach to SMEs is also constrained by default risk. Banks generally do not lend to whoever would be willing to pay higher interest rates because doing so would attract riskier borrowers with higher default probability. One way for banks to circumvent the asymmetric

information problem is to screen out borrowers through non-interest rate devices such requiring collateral or demonstrated capability based on audited financial information (Mishkin & Eakins, 2006; Howells & Bain, 2007; and ITC, 2009).

The lack of audited financial statements that banks can assess tends to exclude SMEs from consideration by prudent lenders. The opaqueness of SMEs makes it difficult for banks to determine if they have the capacity and/or the willingness to pay. This opaqueness results partly from conscious decisions on the part of small business owners not to disclose more information than absolutely necessary, and partly from a lack of understanding among SMEs about the importance of communicating openly and regularly with their bankers (ITC, 2009).

During economic downturns, SMEs tend to experience bankruptcies more than large firms because they have fewer resources to fall back on. SMEs also tend to have weaker management skills to anticipate and respond to adversity. The greater probability of defaults by SMEs is another reason for bank reluctance to loan to this sector (ITC, 2009; and Howells & Bain, 2007).

#### **2.3.1.4 Limited collateral**

Collateral – security in the form of assets – is a way for banks to recover money in the event of default. Without adequate collateral, banks have limited or no ways to protect their loaned assets. SMEs’ lack of collateral is another dissuasive factor for financial institutions. Even if collateral is available, in countries where there is no reliable registry for mortgages, liens and other encumbrances, the quality of the collateral may not be what it seems because it might have already been pledged for other loans. Legal systems in countries where it is difficult for banks to enforce rights to collateral also contribute to bank caution in SME lending (ITC, 2009; Mishkin & Eakins, 2006; and Howells & Bain, 2007).

#### **2.3.2 Barriers to formal finance: SMEs perspective**

In the previous section, difficulties raised in providing financing from the financial institution perspective as; small loans are more costly to monitor and administer, SMEs are diverse and more opaque than large firms, thus their risk profile is less favorable, and with limited collateral, their ability to offset higher levels of risk with security for the bank is very limited. In addition to these challenges, SMEs, by their own actions, can compound the problem. SMEs often fail to address the concerns of lenders; their behaviors’ can inadvertently reinforce those concerns and perpetuate restricted access to financing. For instance the study by Brhane, (2014) presents

inadequate loan size, high interest rate, poor bookkeeping system, information gap about finance, tendency of group collateral requirements, fear of business failure, short term duration, failure to disburse loan timely, and inconvenient loan as discouraging factors for access to finance by SMEs.

Similarly other studies show additional factors like age of the partner, educational level of the entrepreneur, possession of fixed asset, employment size of MSEs, and perception about lending procedure and loan repayment period (Selamawit et al. 2014; Kofi et al., 2013; and Belanova, 2013).

## **2.4 Empirical Review**

For the sake of this study only, empirical evidences from local and other country experience have been discussed by grouping in to four major factors as; owner-manager personal characteristics, firm own characteristics, firms' relationship with finance provider, and other supplementary factors.

### **2.4.1 Owner-Manager Personal Characteristics**

SMEs access to formal source of finance is impeded by variables related to this characteristic are age of owner-manager, educational level of owner-manager, professional education level of owner-manager, experience of owner-manager, short term training skill of owner-manager, and attitude towards formal finance (Nguyen & Luu, 2013).

**Age of Owner-Manager:** as far as age of owner-manager is concerned, it have a significant impact on access to finance that is the older the owner-manager the lesser the probability of getting barrier to credit. In other words firm's owner-managers who are older and with professional experience have higher probability to access formally external funds than the others (Nguyen & Luu, 2013; and Selamawit et al. 2014). Moreover empirical results indicate older entrepreneurs with the age category of 31-40 as well as 41-50 are considered creditable or worthier of credit than the other age groups (Kofi et al.). As a result Commercial banks are willing to extend more credit to the old entrepreneur than the young one. The reason is that young entrepreneurs are less wise and less responsive than the old one. The result is consistent with the relationship of age and experience in business management (Kofi et al.).

**Educational level of Owner-Manager:** regarding educational level of the entrepreneur, empirical result shows different results. Some studies consider as barrier for access to formal credit from formal financial institutions (Selamawit et al.). On the other hand, Kofi et al. shows that there is no relationship between access to finance and educational level of entrepreneurs. As per this study banks or financial institutions don't consider the level of education of entrepreneurs before granting a loan. Furthermore other study result also explains that educational levels and experience of owner manager have no significant influence on SMEs in accessing bank loan (Hassen & Abdwahab, 2014).

**Attitude of Owner-Manager:** another determinant is attitude of owner-managers towards formal finance which affects usage in external source of finance significantly. Some owner-managers limit themselves from granting loan just because of their negative attitude towards formal credit. Empirical evidence by Selamawit et al. support the theory that is perception about lending procedure reflect obstacles for access to formal credit from formal financial institutions.

**Gender of Owner-Manager:** on the subject of gender of owner-manager the empirical result seems two fold; significant and insignificant. Various studies indicate that gender decides access to finance by SMEs. For instance the study by Kofi et al. empirically proves gender of the entrepreneur significantly affects access to credit; male entrepreneurs are most favored by financial institutions than female counterparts. On the other hand, the result bring by Selamawit et al. is different from the previous implying gender of the entrepreneur has no significant effect on enterprises access to credit from formal financial institution.

#### **2.4.2 Firm Own Characteristics**

Variables representing enterprises or firms characteristics are age of the enterprise, size of the enterprise in terms of total asset and collateral in terms of fixed asset investment.

**Age of enterprises:** Beck & Cull (2014) found the likelihood to have a formal loan by large enterprises are more than SMEs and similarly the likelihood to have a formal loan by older firms are more than younger firms. Moreover, an older firm has a higher probability of successful loan application (Hassen & Abdwahab, 2014). On the other hand, the result brings by Selamawit et al. is different, age has no significant effect on MSEs' access to credit from formal financial institution.

**Size of the firm:** size of the firm do matter as constraint to access to finance implying small firms are likely to have more trouble than large one in access to finance (Nguyen & Luu, 2013). Similarly, firm's size and difficulty to obtain bank loan is negatively implying a large firm has a higher probability of successful loan application (Hassen & Abdwahab, 2014). Moreover the likelihood to have a formal loan by large enterprises is more than SMEs and similarly the likelihood to have a formal loan by older firms are more than younger firms (Beck & Cull, 2014). Statistically small firms are around 30% and medium size firms are around 14% less likely to have a formal loan than large firms meaning older firms are more likely to use formal lending than other firms.

**Collateral:** surprisingly almost all empirical studies agree that bringing collateral significantly decides access to formal finance of SMEs compared with large firms. As a result various studies reveal that the major obstacle to access external finance is due to lack of collateral (Brehanu & Mesfin, 2015; Brhane, 2014; Selamawit et al.; Hassen & Abdwahab, 2014; and Belanova, 2013). According to the study by Brehanu & Mesfin (2015) most companies in the form of SMEs in Dilla town obtain access to finance through informal systems because such a system is not demanding them any collateral.

In addition to that request of collateral and guarantee by formal financial institutions make formal credit very difficult to be accessed by MSEs' (Brhane, 2014). One of the obstacles for access to formal credit from formal financial institutions listed by Selamawit et al. is possession of fixed asset. Hassen and Abdwahab (2014) also explain that Banks in Libya rely more on collateral than written business plan. As a result the influence of business plan on loan access is not significant in Libya. All in all providing of a collateral or guarantee is a decisive factor (Belanova, 2013).

**Form of business organization:** form of business organization or legal status of firms', as described in few studies, has a significant impact on access to formal credit. Form of business organization expressed in terms of sole-proprietorship, partnership or corporation. Various studies finding explain that simplest organizational form, partnership and sole proprietorship are less likely to have a formal loan (Beck & Cull, 2014; and Kofi et al.) of which retail and general service firms are consider worthier of financial credit than those in the manufacturing sector

(Kofi et al.). In contrast, in Libya type of ownership of SMEs is found to be not important as constraint for access to finance (Hassen & Abdwahab, 2014).

**Accounting record keeping:** on the subject of accounting record keeping behaviors of enterprises, empirical result proves that, it have significant impact on access to credit. Nguyen & Luu (2013) found that large enterprises have good accounting book of record than small enterprises. As a result small firms are likely to have more trouble than large one in access to finance

**Number of employees:** concerning number of employees, SMEs with a very few number of employees are those that receive credit than SMEs with more than 7 employees (Kofi et al.) and also local study by Selamawit et al. come up with similar result which is employment size of MSEs matter for access to formal finance.

**Type of sector:** regarding type of sector like service, agriculture, manufacturing and the like empirical results shows that, in terms of risk, the difference in sectors also creates difference in risk exposure. In addition, when looking across different sectors, the risk also differs. The result of Kofi et al. is in line with this expression. In terms of risk, they found that service sector is most favored than those in the production and agricultural sector due to volatility of the latter sector which leads to loan default. While local study result by Selamawit et al. is totally different, access to credit is not determined by type of sector.

### **2.4.3 Firm Relationship with Finance Provider**

The third broad category in determining access to formal finance is intimacy of the enterprise or enterprise owner-manager with finance provider institution and individuals within the institution. Based on the result of various empirical studies it plays a great role in access to formal finance (Nguyen & Luu, 2013; and Hassen & Abdwahab, 2014). It is empirically proofed that networking decides access to credit particularly in developing countries whose financial system is underdeveloped. Empirical evidence reveal that the more and frequently firm contact bank officials, the firm's ability to access to bank and other source of capital will be higher (Nguyen & Luu, 2013). Furthermore the study by Hassen & Abdwahab (2014) in Libya indicates that the probability of loan approval is speed up if the relationship with banks is tight.

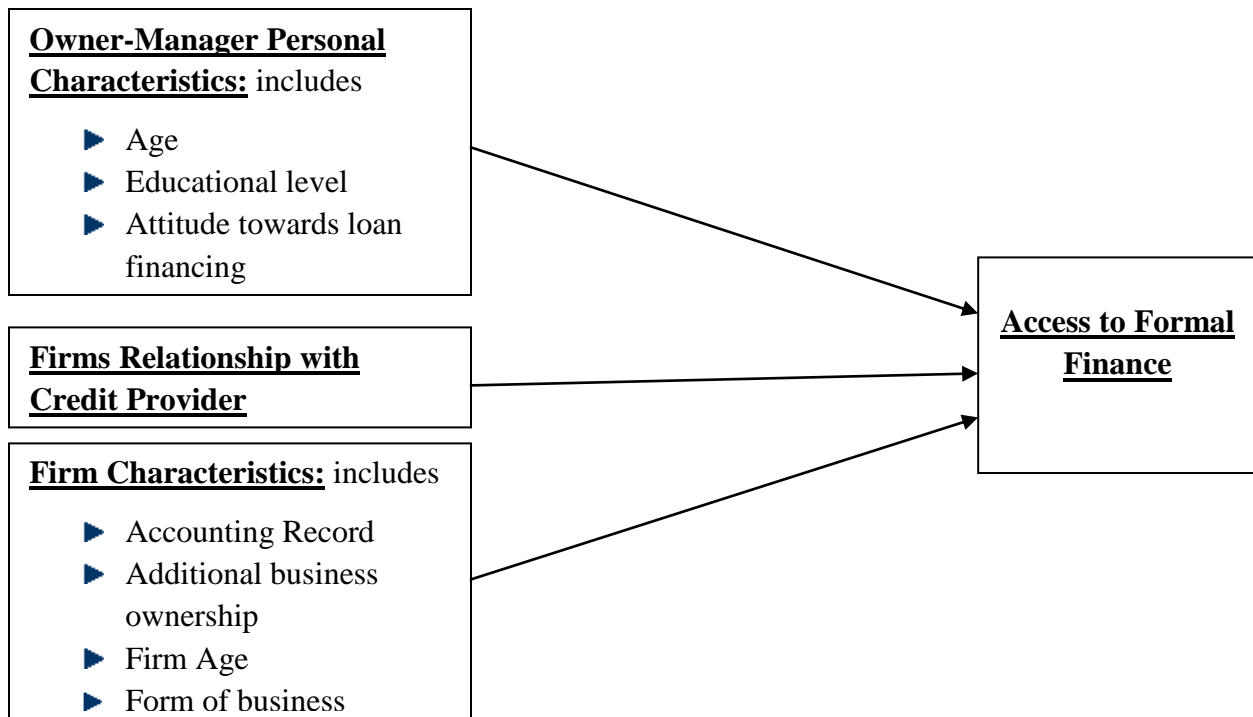
#### 2.4.4 Other Supplementary Factors

In addition to previous factors locations of firms decide access to formal finance. Regarding this, empirical evidences show that geographical area significantly affects access to finance. As per study results, surprisingly it is oppose to what people expect, firms located in big cities are less likely to access formal credit (finance) and tends increasingly to use debts from informal finance and firms in rural areas relatively use higher formal credit and lesser informal credit (Nguyen & Luu, 2013).

### 2.5 Conceptual Framework

From the previous literature review, the study finds different variables that could explain access to formal finance of SMEs as well as that could impede their intension to use external financing worldwide. Those variables, for the sake of this study, can be divided into three as owner-manager personal characteristics, firm characteristics and firms' relationship with credit provider. Therefore based on the previous discussion, the conceptual framework of this study is presented below in Figure 2.1 to find out what explains access to formal finance of SMMEs in Addis Ababa region.

**Figure 2.1 Conceptual Framework**



**Source: The researcher own reflection**



Figure 2.1 illustrates how the concepts in the framework are related. Summarizing the results from numerous studies, Personal characteristics of owner manager, firm characteristics and firms relations with credit provider significantly determine access to formal finance of Small and Medium Manufacturing Enterprises. Owner-manager personal characteristics include age, educational level and attitude towards external financing; and firm characteristics include maintaining accounting book of records, additional business ownership, age of the firm, and form of business. On the other hand, firm's relation indicates the level of intimacy of SMMEs with loan provider financial institutions.

Overall, the framework shows owner-manager characteristics, firm characteristics and bank relation as another independent variable and access to finance as a dependent variable.

## **2.6 Conclusion and Literature Gap**

Most of the empirical evidences from both local and other countries experience are similar but there is some difference in owner characteristics and firm characteristics. The reason for owners' characteristics and firm characteristics mixed impact on accessibility of formal finance is due to differ in study countries (Nguyen & Luu, 2013). Here it is clearly shown from empirical findings that, reason for different result in different countries is due to geographical factor.

In Ethiopia, few researches are undertaken in different regions. But, those studies are different in their research design and coverage of geographical area. For instance, the study undertaken by Gebrehiwot & Wolday (2006) is a descriptive type of study conducted in six major towns namely Addis Ababa, Nazret, Awassa, Bahir Dar, Jimma, and Mekele while the study is limited to describing rather than explaining the factors contributing for access to formal finance.

On the other hand, the study by Brehanu & Mesfin, 2015; Brhane, 2014; and Selamawit et al., 2014 are explanatory type of research and undertaken out of Addis Ababa. For instance, the study by Brehanu & Mesfin (2015) assess factors affecting access to finance with reference to MSE's in Dilla Town; the study by Brhane (2014) assumed in Debre Markos town; and the study by Selamawit et al., (2014) assess the major determinants of access to finance in a case of Asella town.

For that reason, the uncovered area concerning determinants of access to formal finance is mixed result due to differ in geographical area. Therefore, it can be concluded that there is no

comprehensive explanatory study undertaken in Addis Ababa Administrative City and this study have been undertaken to fill the gap, factors affecting access to formal finance, for the case of Addis Ababa using a survey of 180 SMME's operating under the administrative city.

# **CHAPTER THREE**

## **RESEARCH DESIGN AND METHODOLOGY**

This chapter presents the research design and methodology adopted for the data collection, including the questionnaire administered during the study. It is organized in seven basic sections. The first section deals about research design employed in this study. The second section presents the target population of the study and the sample size taken including the technique of selecting samples. The third and fourth section deals about source of data and data gathering instruments, respectively. In the fifth section procedures of data gathering and pilot study is included and methods of data analysis including definitions of variables are presented in the sixth section. Section seven presents literature driven hypothesis, respectively. Overall speaking, this chapter forms the basis for the data analyses and interpretation of findings which is presented in the next chapter.

### **3.1 Research Design**

The research design used in this study is explanatory which is useful in order to explain the relationship between dependent and independent variables. Therefore being explanatory helps the study to give details about the influence of explanatory variable on access to formal finance. In addition to that, this study is organized as a quantitative research type because the actual collected data can be quantified interims of number and consequently quantitative data analysis technique is employed.

### **3.2 Sampling and Sampling Techniques**

The target population of this study is Small and Medium Scale Manufacturing Enterprises operating in Addis Ababa. As per the data collected from Micro and Small Enterprises Bureau (MSEB), there are 1,482 Small manufacturing Enterprises and 660 Medium Manufacturing Enterprises. The recent regulation, regulation No. 373/2016, states the definition of both Small Manufacturing Industry and Medium Manufacturing Industry as follows. Small Manufacturing Industry means an industry having a total capital, excluding building, Birr 100,001 to Birr 1,500,000 in the manufacturing sector and engages from 6 to 30 workers including the owner, his family members and other employees. Medium Manufacturing Industry means an industry

having a total capital, excluding building, from Birr 1,500,001 to Birr 20,000,000 in the manufacturing sector and engages from 31 to 100 workers including the owner, his family members and other employee. The population in terms of sub-city is presented on Table 3.1 below.

**Table 3.1 Target population of the study**

S/A	Sub City	Small Scale Manufacturing Enterprises	Medium Scale Manufacturing Enterprises	Small and Medium Scale Manufacturing Enterprises
1	Ledeta Sub City	43	44	87
2	Kirkos Sub City	45	29	74
3	Bole Sub City	117	67	184
4	N/Silk Sub City	264	140	404
5	Arada Sub City	170	49	219
6	Akaki Kality Sub City	138	109	247
7	Addis Ketema Sub City	93	65	158
8	Kolfe Sub City	297	58	355
9	Yeka Sub City	116	64	180
10	Gulelle Sub City	199	35	234
	<b>Total</b>	<b><u>1,482</u></b>	<b><u>660</u></b>	<b><u>2,142</u></b>

**Source: Data collected from Micro and Small Enterprises Bureau (MSEB)**

As it is presented in the above Table 3.1 it is difficult to apply census which mean taking the whole population as a study participant. Based on this reason, the researcher assume failure and success value of 0.5, 95 percent confident interval ( $Z^2=1.96$ ), and tolerable error is set at 7 percent and determine a sample size as 179 Enterprises using scientific formula based on Kothari (2004) as follows;

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

Where: **N** = size of population;

**n** = size of the sample;

**p** = sample proportion of successes;

**q** = 1 – p;

**z** = standard variate for given confidence level (as per normal curve area table);

**e** = acceptable error (the precision).

$$n = \frac{(1.96)^2 * (0.5) * (0.5) * (2,142)}{(0.07)^2 * (2,142-1) + (1.96)^2 (0.5) * (0.5)}$$

$$= \frac{2,057.1768}{10.4909+0.9604}$$

$$= \underline{179}$$

The researcher used a probabilistic sampling technique which is useful to explain, predict and generalize to the whole population. The technique of sampling used in this study is a stratified sampling with systematic sampling under each stratum. Using this technique the researcher first determines the representative sample. Next to that, the total population stratified as Small Manufacturing Enterprise and Medium Manufacturing enterprise as per the regulation and proportionate method is applied to facilitate sample size from each stratum. Based on this, from the total population of 2,142 Small and Medium Manufacturing Enterprises operating in Addis Ababa Administrative City, 179 samples are determined. Consequently, 124 and 55 samples are taken from each stratum by applying proportionate method as indicated in the following Table3.2.

**Table 3.2 Application of Proportionate method for sample determination**

Stratum	Population	Proportion	Overall Sample size	Proportionate sample size
Small manufacturing enterprises	1,482	1,482/2,142= 69.2%	179	124
Medium manufacturing enterprises	660	660/2,142= 30.8%	179	55
	<b><u>2,142</u></b>			<b><u>179</u></b>

**Source: The researchers own computation**

Initially, the researcher plans to take each sub city as a stratum while there is no heterogeneity on the data provided. As a result, Stratified Sampling was applied on the two different scales that is Small Manufacturing Enterprise as a one stratum and Medium Scale Manufacturing as another stratum. The researcher plans and performs this sample very carefully and believes to give accurate information about the general population.

### **3.3 Data Type and Source**

To fulfill the general as well as specific objectives of the study, primary source of data in the form of opinion of owners (managers in absence of owners) is fundamental for the sake of this study. Opinion regarding previous stories of obtaining loans; including personal and firm based characteristics are collected from owners of Small and Medium Scale Manufacturing Enterprises and from managers of those enterprises in absence of managers.

### **3.4 Data Gathering Instrument**

By considering the time scale and budget the research method used in this study was survey work in the form of questionnaire. The questionnaire is composed of a combination of closed and open ended questions. Being a combination of both close ended and open ended questions works best because it provides respondents with a number of defined responses, and also an additional category (other) that they can write the response they wish to give if it is not listed. For open ended purpose a line of two is provided so that they can write the response they wish to give.

The first part of the questionnaire is designed to generate statistics and the second part asks people for a more in-depth opinion. Furthermore, the second part consisted of general characteristics of the owner-manager including all the twelve determinants of SME's financing identified in the literature. Several items on each construct were developed and adapted from relevant literature (Fjose, Grunfeld, & Green, 2010). Regarding the items raised, there are few dichotomous type and many five-point Likert scale type items measured in five-point (scale attach at 5 for strongly agree and 1 for strongly disagree; and 5 for extremely tight to 1 for not tight ) and in three-point (scale attach 3 for successful, 2 for partially successful and 1 for unsuccessful).

### **3.5 Procedure of Data Gathering and Pilot Study**

Research techniques are step-by-step procedures which you can follow in order to gather data, and analyze them for the information they contain (Kothari (2004). Before starting a data gathering, 5 questioners, which are designed based on literature, are distributed for SMEs owners-managers. The main purpose of distributing few questionnaires is to take a pilot test. Based on the pilot test result, the researcher try to insure the vagueness of each items in the questionnaire by looking the response of each respondent and also try to insure vagueness of the instruction written before filling each item. In addition to that, pilot test is undertaken on the same type of target population in order to maintain the validity. After some discussion and analysis the researcher excludes and modifies some items that were not understood by the respondents in the same way. Similarly, two items from the questionnaire were picked up because it is believed to offend potential respondents.

Regarding the procedures followed while gathering the data, primarily before requesting their support by filling the questionnaire the purpose of the study was explained to them. In addition to that, they were assured of the confidentiality of the information they were going to provide and were assured that it will not affect their employment status (if the respondent is a manager) in the organization nor the organization in any way. Also, they were assured that the information they provided was to be used for research purposes and the information was not going to be disclosed to a third party without their consent and their response was going to be treated as a unit during the analysis. Fortunately, Small and Medium Manufacturing Enterprises are located in industry village all together and it eases the suffering of data collection.

### **3.6 Methods of Data Analysis**

After relevant data regarding the study area are collected, the researcher use the statistical package for social science (SPSS) to analyze the data obtained from primary source. Quantitative techniques were used to analyze the data. Quantitative data were analyzed using descriptive statistics such as frequency distribution and percentage. A binary logistic model which best fits the analysis for determinant of access to formal finance was employed.

This study was intended to analyze and investigate the collected data to determine which of the explanatory variables are predictive of access to formal finance. The dependent variable is a

dummy, which takes a value of zero or one depending on whether or not SMMEs use formal finance (loan). However, the independent variables were both continuous and discrete.

The researcher prefer the logistic regression model because the probabilities are bound between zero and one whereas Linear Probability model (LPM) estimated probability values can lie outside the normal probability of zero and one range which is taken as a major weakness for the model. Moreover, logistic regression model best fits if there is a non-linear relationship between the probabilities and the explanatory variables and for analysis purpose of dichotomous outcome variables meaning two outcomes like occur and not occur (Sabine & Brian, 2004; and Julie, 2007).

Therefore the binary logistic regression model, in this study, helps to identify major determinants of access to finance by SMMEs. Based on empirical evidences presented in chapter two, the researcher uses a binary logistic regression model provided by Nguyen & Luu (2013) with some modification.

Initially the model proposed by (Nguyen & Luu, 2013) to be tested have five major dependent variables that are owner characteristics, firm characteristics, region, networking and ownership. From those explanatory variables region is excluded because of this study is limited to Addis Ababa. Explanatory variables expressing owner-manager characteristics include educational level, Age of owner-manager, knowledge of tax shield advantage on loan, attitude of owner-manager, and gender of owner manager. Of which gender and knowledge of tax shield advantage on loan are insignificant and due to that it is excluded from the model. Explanatory variables expressing firm characteristics include firm's age, form of business, accounting record, additional business, form of business, business plan, and employee number. Of which employee number, business plan and form of business are excluded from current study model because of their statistical value become insignificant. Therefore, after those modifications the logistic regression model to be tested by this study can be further explained as follows;

$$\text{ACCESS}_i = \alpha_0 + \beta_1 \text{Age}_i + \beta_2 \text{Bank\_Rel}_i + \beta_3 \text{Acctg\_Rec}_i + \beta_4 \text{Attitude}_i + \beta_5 \text{Edu\_level}_i + \beta_6 \text{Firm\_Age}_i + v_i$$



**Table 3.3 dependent and independent variables of the study**

<b>Variable Name</b>	<b>Represent</b>	<b>Measurement</b>	<b>Expected Result</b>
<b><i>Dependent Variable</i></b>			
ACCESS <sub>i</sub>	access to formal finance	dummy variable coded as 1 if the firm uses formal finance (loan) 0 if the firm not use	
<b><i>Independent Variable</i></b>			
Age <sub>i</sub>	the owner-manager age	continuous variable	+ve sig.
Bank_Rel <sub>i</sub>	level of relationship with bank	categorical variable coded as 1 if it is not tight, 2 if it is slightly tight, 3 if it is tight, 4 if it is very tight, 5 if it is extremely tight	+ve sig.
Acctg_Rec <sub>i</sub>	if firm has an accounting book of records or not	dummy variable coded as 1 if they have accounting book of records, 0 otherwise	+ve sig.
Attitde <sub>i</sub>	Attitude of owner-manager towards formal finance	dummy variable coded as 1 if they perceive as loan is necessary, 0 otherwise	+ve sig.
Edu_level <sub>i</sub>	the highest educational level of owner-manager	categorical variable coded as 1 if it is primary, 2 if it is secondary, 3 if it is preparatory, and 4 if it is college or university	+ve sig.
Firm_Age <sub>i</sub>	Age of SMMEs starting from establishment	categorical variable coded as 1 if it is below 1year, 2 if it is 1-3, 3 if it is 4-6, and 4 if it is 7 and above	+ve sig.
<b>v<sub>i</sub></b>	Represent the error term		
<b>α<sub>0</sub></b>	represent the constant value		

+ve sig: represents there is a positive and significant relationship

**Source: Researcher own reflection**

### **3.7 Literature Driven Hypothesis**

Based on the empirical evidences from previous studies the researcher set the following hypothesis.

As discussed under the literature review age of enterprises affect the likelihood of getting formal credit (Nguyen & Luu, 2013; and Selamawit et al. 2014). The older the manager the lesser will be the probability of getting barrier to credit. Here the justification is that young owners are less wise and less responsive than the old one ( (Kofi, Paul, & Gaeten, 2013; Nguyen & Luu, 2013; and Selamawit et al., 2014). Based on this empirical evidence the researcher set the following alternative hypothesis

***Hypothesis 1: there is a positive and significant relationship between age of SMMEs owner-manager and obtaining formal finance.***

Based on the result of various empirical studies, bank relation plays a great role in access to formal finance (Nguyen & Luu, 2013; and Hassen & Abdwahab, 2014). It is empirically proofed that networking decides access to credit particularly in developing countries whose financial system is underdeveloped. Empirical evidence reveal that the more and frequently firm contact bank officials, the firm's ability to access to bank and other source of capital will be higher (Nguyen & Luu, 2013). Furthermore the study by Hassen & Abdwahab (2014) in Libya indicates that the probability of loan approval is speed up if the relationship with banks is tight. Therefore, based on this empirical finding the researcher set the following alternative hypothesis.

***Hypothesis 2: there is a positive and significant relationship between bank relation of SMMEs and obtaining formal credit.***

Maintaining book of accounts has its own contribution for obtaining external source of finance implying increase the likelihood to access formal finance (Nguyen & Luu, 2013).empirical results proof that,accounting record keeping behaviour of enterprises have significant impact on access to credit (Nguyen & Luu, 2013).the reason is large enterprises have good accounting book of record than small enterprises. As a result small firms are likely to have more trouble than large one in accessto finance. Bases on this argumet the researcher set the following alternative hypothesis.

***Hypothesis 3: SMMEs which maintain accounting book of records have positive and significant relationship with obtaining formal credit.***

Another determinant factor in obtaining formal loan is attitude of owner-managers towards formal finance affect source of finance significantly. As per the study by (Selamawit et al., 2014)

some owner-manager limit themselves from granting loan just because of their negative attitude towards formal finance. Based on this empirical evidence, the researcher set the following alternative hypothesis.

***Hypothesis 4:*** *SMMEs with positive attitude towards external finance have a positive and significant influence in obtaining access to finance.*

Educational level of owner–manager highly explains firms possibility to obtain formal finance (Nguyen & Luu, 2013; and Selamawit et al. 2014). According to Selamawit et al., (2014) educational level of owner-manager is barrier for access to formal finance from formal financial institutions. On the other hand Kofi et al., (2013) shows that there is no relationship between access to finance and educational level and Hassen and Abdwahab (2014) justifies the reason as financial institution don't consider the level of education of owner-manager before granting a loan. Based on this empirical evidence, the researcher set the following alternative hypothesis.

***Hypothesis 5:*** *there is a positive and significant relationship between educational levels of SMMEs owner-manager has positive and significant relationship with access to formal finance.*

According to Beck and Demingue (2006) the likelihood to have a formal loan by older firms are more than younger firms and Hassen and Abdwahab (2014) support this idea as older firms has a higher probability of successful loan application. On the other hand, the result bring by (Selamawit et al. (2014) is different, age has no significant effect on MSEs access to credit. Based on this empirical evidence, the researcher set the following alternative hypothesis.

***Hypothesis 6:*** *there is a positive and significant relationship between firm age and access to formal finance.*

# CHAPTER FOUR

## DATA PRESENTATION AND ANALYSIS

The fourth chapters of the study present analyze and interpret survey data using primary data sources and collected from owner-manager of SMMEs operating under Addis Ababa. This chapter is organized and presented in to two major sub sections. The first sub section explains the response rate concerning distributed questionnaire. The next sub section presents empirical evidences and discussion of findings. Under the second sub section, three sub topics are discussed including: little descriptive analysis of explanatory variables compared with dependent variable which is believed as necessary to provide before discussing determining variables for access to formal finance; summary of model fit assumption; and the output of binary logistic regression method which focuses more on level of influence of each explanatory variable on the predicted variable.

### 4.1 Response Rate

A well-planned survey should obtain at least a 40 per cent response rate and with the judicious use of different reminders, a 70 per cent to 80 per cent response level should be possible (Louis, Lawrence, & Keith, 2005:263). Table 4.1 shows that the total questionnaire distributed for study participant were 215 of which only 180 questionnaires are returned.

**Table 4.1**Response rate

<b>Respondent</b>	<b>Number of questionnaire distributed</b>	<b>Number of questionnaire returned</b>	<b>Response rate</b>
SMMEs Owner-Manager	215	180	83.7%

**Source: survey data (2016)**

As a result the responses rate is 84 percent. Therefore, based on the returned questionnaire the study can perform generalization and conclusion

### 4.2 Empirical Result and Discussion

Before discussing regression results it is better to perform a descriptive analysis of each predictor and its relation with the outcome variable. Result from this initial analysis provides much insight into potentially viable models for the data (Chao-Ying & Tak-Shing, 2002). Therefore, the

presentation, empirical result and discussion are presented in to three sub sections. Primarily descriptive statistics of variables are discussed, next model fit assumptions presented and finally outputs of binary logistic results are discussed.

#### 4.2.1 Descriptive Statistics of Variables

In this section, descriptive statistics for the dependent variable access to finance and explanatory variables including age of owner-manager, bank relation with credit provider, accounting record of the enterprise, attitude of the owner-manager regarding external financing, educational level of owner-manager, and age of enterprises in year involved in the regression model are presented. The data will be analyzed using cross tabulation tables among access to finance and explanatory variables. Therefore, each explanatory variable is cross referenced with those enterprises having a loan and those enterprises haven't a loan.

**Table 4.2 Cross tabulation of access to formal finance and maintaining accounting record**

		Do you have accounting book of records?		Total
		No	Yes	
Do you have a loan?	No	29	73	102
	Yes	19	50	69
Total		48	123	171

**Source: survey data (2016)**

**Accounting record keeping:** Regarding maintaining book of accounts Table 4.2 indicates 123 (71.9%) state that, they have an accounting book of records of which 73(59.35%) are those with no access for loan and 50 (40.65%) are those with access to loan. Here majority of the respondent who maintain book of accounts are enterprises without loan. On the other hand the remaining 48 (28.1%) participants have not maintain proper book of records, of which 29 (60.42%) are those with no access to loan and remaining 19 (39.58%) are those enterprises without loan. Here again, it implies that even those enterprises not maintaining book of records can get access to finance.

**Table 4.3 Cross tabulation of access to formal finance and relation with credit provider**

		How do you express your relationship with credit providers?					Total
		Not Tight	Slightly tight	Tight	Very tight	Extremely Tight	
Do you have a loan?	No	52	35	8	8	4	107
	Yes	13	21	7	15	17	73
Total		65	56	15	23	21	180

Source: survey data (2016)

**Relation with credit provider:** as far as access to finance is concerned relationship with fund providers including bank and microfinance institution have its own impact (as discussed in literature of review) on firms in obtaining formal finance. To assess this issue the study participants were asked to rank their relationship with bank and respond as; not tight (36.1%), slightly tight (31.1%), tight (8.3%), very tight (12.8%), and as extremely tight (11.7%). As presented in the cross tabulation Table 4.3, from those participants answering as ‘extremely tight’, which is the highest response, 80.95 percent are enterprises with access to loan and the remaining 19.04 percent are enterprises without access to loan.

Similarly, from those participants answering as ‘not tight’, which is the lowest response, only 20 percent are enterprises with access to loan meaning the remaining 80% are enterprises without loan. The preceding two analysis indicates that majority of enterprises with access to loan have an extreme tight relationship while majority of the respondents as no relation are enterprises without loan.

**Table 4.4 Cross tabulation of access to formal finance and perception of loan**

		Do you think bank loan is necessary?		Total
		No	Yes	
Do you have a loan?	No	9	93	102
	Yes	5	65	70
Total		14	158	172

Source: survey data (2016)

**Attitude of owner-manager:** Table 4.4 indicates that, to evaluate the attitude of owner-managers respondents were asked for the necessity of formal loan, 91.9 percent agreed with necessity of loan and 8.1 percent not agreed. This shows that majority of the participant already decided on importance of formal loan whether they have a loan or not. In other words, the implication is both enterprises with access to loan and without access to loan have the same perception regarding necessity of formal credit.

**Table 4.5 Cross tabulation of access to formal finance and educational level of respondents**

		Educational level of the respondent				Total
		Primary or less	Secondary	Preparatory	College or above	
Do you have a loan?	No	25	41	12	29	107
	Yes	10	18	17	28	73
Total		35	59	29	57	180

Source: survey data (2016)

**Educational level of owner-manager:** educational level of the owner manager, which is measured by primary, secondary, preparatory, and college or university, plays a great role in growth and decision making process of enterprises. As per the above Table 4.5, educational background of enterprise owner-managers shows that, Primary level (19.4%), Secondary level (32.8%), preparatory (16.1%), and college or university level (31.7%). This result indicates low educational level by SMMEs owner-manager which may be an obstacle in business management including obtaining access to finance (Nguyen & Luu, 2013).

Regarding the highest educational level, college or university, the proportion of enterprises with access to loan and without access to loan are 50.88% and 49.12%, respectively, indicating in this category there is no significant difference on those obtaining loan and not obtaining loan. Similarly, the forth column shows that, the more loan accessible level of education is preparatory because at this level of education 58.62% are those enterprises with access to loan while the remaining 41.37% are those without loan. The remaining two educational level categories indicate that, the proportion of enterprises with loan decreases while the reverse is true for enterprises without loan. It can be interpreted as, the lower the educational level the higher will be the difficulty to obtain formal loan easily.

**Table 4.6 Cross tabulation of access to formal finance and age of the firm**

		Age of the firm in terms of year				Total
		1 year or below 1 year	1-3 year	4-6 year	7 year or above	
Do you have a loan?	No	21	48	17	21	107
	Yes	10	22	17	24	73
Total		31	70	34	45	180

Source: survey data (2016)

**Age of enterprise:** as per the survey data, Table 4.6 shows that 25% are operated for seven and more years, 18.9% are operated within the range of four to six years, 38.9% are operated for one to three years, and the remaining 17.2% are operated below one year. The proportion of enterprises with access to loan in the first category, below 1 year, and in the second category, 1-3 years in operation, indicates 67.74% and 68.57%, respectively. In the third category, the proportion is equal while the last category, operated for 7 and above, indicate that the proportion of enterprises with access to loan increase to 53.34%, indicating difficulty to get a loan at startup is higher and difficulty declines in line with an increase in age of the firm.

#### 4.2.2 Model Assumptions and Data Properties

The following diagnostic tests were carried out to insure that the data fit and the basic assumptions of Binary Logistic Regression Methods are presented or checked. Logistic



regression does not assume a linear relationship between the dependent and independent variables. The dependent variable must be a dichotomy (2 categories). The independent variables need not be interval, nor normally distributed, nor linearly related, nor of equal variance within each group. The categories (groups) must be mutually exclusive and exhaustive; a case can only be in one group and every case must be a member of one of the groups. Larger samples are needed than for linear regression because maximum likelihood coefficients are large sample estimates. 30 cases per predictor is fair and recommended (Sabine & Brian, 2004).

Regarding the dependent variable, as expressed previously, it is a dichotomous variable with two categories. And it is coded as 2 categories which is helpful to fit with binary logistic regression method. The study takes access to formal finance as a dependent variable with dummy if the response is yes as 1, 0 otherwise. Therefore, it fulfills the first assumption.

**Case Processing Summary:** is a summary which shows the total number of cases observed, missing cases and cases included in analysis (Julie, 2007). Case processing summary is presented in the following table, Table 4.7.

**Table 4.7 Case processing summary**

Unweighted Cases <sup>a</sup>		N	Percent
Selected Cases	Included in Analysis	165	91.7
	Missing Cases	15	8.3
	Total	180	100.0
Unselected Cases		0	.0
<b>Total</b>		<b>180</b>	<b>100.0</b>

a. If weight is in effect, see classification table for the total number of cases.

**Source: Binary logistic regression output**

The case processing summary in Table 4.7 shows that a total number of cases observed are 180 and of which 165 included in analysis while 15 cases selected as missing cases. When running binary logistic regression model, if there is missing in a given case in one of the explaining variables or predicted variable then it will be excluded from the overall analysis (Julie, 2007).

**Omnibus test of model coefficient:** gives an overall indication of how well the model performs, over and above the result obtained for Block 0, with none of the predictor enters in to the model.

This is referred as a ‘goodness of fit’ test. For this set of result a highly significant value is necessary (significant value less than 0.05) (Julie, 2007). It is presented in the following table, Table 4.8.

**Table 4.8 Omnibus tests of model coefficient**

		Chi-square	Df	Sig.
<b>Step 1</b>	Step	44.906	6	.000
	Block	44.906	6	.000
	Model	44.906	6	.000

**Source: Binary logistic regression output**

Table 4.8 shows that a significant effect of access to finance (LR test: chi square= 38.206,  $p < 0.001$ ). Therefore, the model with the set of variables used as predictors is better than SPSS, original guess shown in the block0, which assumed that everyone would report no access to formal finance.

**Hosmer and Lemeshow Goodness of Fit Test:** is the most reliable test of model fit available in SPSS and interpreted very differently from the omnibus test. Here poor fit is indicated by a significant value less than 0.05. So, to support a model the value must be greater than 0.05 (Julie, 2007).

**Table 4.9 Hosmer and Lemeshow Test**

Step	Chi-square	df	Sig.
1	7.931	8	.440

**Source: Binary regression output**

As presented on Table 4.9 the chi-square value for the Hosmer-Lemeshaw Test is 7.931 with a significant level of 0.440. This value is larger than 0.05, therefore indicating support for the model.

**Model summary:** gives us another piece of information about the usefulness of the model. The Cox and Snell R square and the Nagelkerke R square values provide an indication of the amount of variation in the dependent variable explained by the model (from a minimum value of zero to a maximum of approximately 1) (Julie, 2007).

**Table 4.10 Model summary**

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	177.188 <sup>a</sup>	.238	.322

a. Estimation terminated at iteration number 5 because parameter estimates changed by less than .001.

**Source: Binary regression output**

From Table 4.10, the two values of Cox and Snell R square and the Nagelkerke R square are 0.238 and 0.322, suggesting that between 23.8 percent and 32.2 percent of the variability is explained by the set of variables.

**Classification table:** provides with an indication of how well the model is able to predict the correct category for each case. There are two predictive values called positive and negative. Positive predictive value is the percentage of cases that are the model classified as having the characteristics that is actually observed in the group. Negative predictive value is the percentage of cases predicted by the model not to have the characteristics that is actually observed not to have the characteristics (Julie, 2007).

**Table 4.11 Classification table**

Observed		Predicted		
		Do you have a loan?		Percentage Correct
		No	Yes	
Do you have a loan?	No	85	14	85.9
	Yes	30	36	54.5
Overall Percentage				<b>73.3</b>

**Source: Binary logistic regression output**

As presented in Table 4.11, classification table shows misses in classification accuracy, which shows correctly classified and incorrectly classified. There are 99 individuals classified in the model as no access of which 14.1 percent are misclassified as false negative and the remaining 85.9 percent are correctly classified. Similarly from the total 66 individuals classified in the model as there is access for loan 54.5 percent are correctly classified while remaining 44.5 percent are classified as false positive indicating misclassified by the model as there is loan access while actually there is no. Therefore, the overall accuracy of the model is 73.3 percent

implying the model can correctly predict the predicted variables, access to loan, with a few errors of 26.7 percent.

**Multicollinearity:** before proceeding to the maximum likelihood regression the correlation matrix of the dependent and independent variables was checked as presented in the following table, Table 4.12.

**Table 4.12 Correlation matrix between independent variables**

	<b>Age</b>	<b>Bank Relation</b>	<b>Accounting Record</b>	<b>Loan Necessity</b>	<b>Educational level</b>	<b>Firm Age</b>
Constant						
Age	<b>1.000</b>					
Bank_Relation	.252	<b>1.000</b>				
Acctg_Record	.081	.163	<b>1.000</b>			
Loan_Necessary	.170	-.025	.143	<b>1.000</b>		
Edu_level	.203	.023	.008	-.132	<b>1.000</b>	
Firm_Age	-.500	-.216	-.127	-.002	-.048	<b>1.000</b>

**Source: Binary logistic regression output**

As presented in the above Table 4.12 the maximum correlation coefficient is 0.252 and the minimum is -0.50. Therefore, there is no serious multicollinearity between the independent variables, so all of them are included in the regression models.

### **4.2.3 Binary Logistic Regression Result**

In this subtopic the study investigate the level of relationship and magnitude of explanatory variables over predicted variable based on the logistic regression model output. Therefore, finally the finding determines which of the explanatory variable are predictive of access to formal finance. Here the data analyzed is “variable in the equation table” from output of the regression.

The variable in the equation table gives information about the contribution or importance of each of a models predictor variable. The test that is used here is known as the Wald test, and the value of the statistics for each predictor in the column labeled Wald. Value less than 0.05 in the sig. column are the variables that contribute significantly to the predictive ability of the model (Julie, 2007). The variable in the equation table is presented below.

**Table 4.13 Variables in the equation table**

Variables in the equation	B	S.E.	Wald	Df	Sig.	Exp(B)	95% C.I. for EXP(B)	
							Lower	Upper
Age	.066	.026	6.217	1	.013	1.068	1.014	1.124
Bank_Relation	.703	.151	21.758	1	.000	2.019	1.503	2.713
Acctg_Record	.370	.417	.785	1	.376	.691	.305	1.565
Loan_Necessary	.175	.718	.059	1	.808	1.191	.291	4.869
Edu_level	.368	.172	4.608	1	.032	1.445	1.033	2.023
Firm_Age	.097	.210	.213	1	.644	1.102	.730	1.664
Constant	-5.337	1.345	15.754	1	.000	.005		

a. Variable(s) entered on step 1: Age of owner-manager, firms' level of relation with bank, Accounting record practice of firms, attitude regarding external source of finance, Educational level of owner-manager, and Firm Age in terms of year.

**Source: Binary logistic regression output**

**Age of owner-manager:** output presented on Table 4.13 shows that there is positive and significant relationship between age of owner-managers and the likelihood of obtaining formal finance. Assuming other variables constant, the Wald's tests for extra year in owner-managers age shows significant ( $\chi^2 = 6.217$ ,  $p < 0.05$ ) effect on access to formal finance. Looking on 95 percent confidence intervals for the odd ratio, the result indicate that the odd (Exp (B)) of access to formal finance were 1.689 times higher for every year increase in age of owner-managers.

Therefore, the regression output implies that the probability of getting formal finance is determined by age of owner-managers who operate Small and Medium Scale Manufacturing Enterprises. As a result, there is enough evidence to retain the proposed hypothesis and it is statistically positively significant in the case of Addis Ababa.

This finding is in line with Kofi et al. (2013); Nguyen & Luu (2013); and Selamawit et al. (2014) results. Age of owner-manager is a determinant factor which likely helps reduce the firms financing obstacles and when the owner become older and older he/she will be the more risk

averse and less energetic. Similarly, those studies clearly justify as young owners are less wise and less responsive than the old one and that makes age a determinant factor.

**Relations with Credit Provider:** as far as firm's relation with credit provider is concerned, the presented output on Table 4.13 shows that there is positive and significant relationship between firm's relation with fund provider and the likelihood of obtaining formal finance. Assuming other variables constant, the Wald's tests for enhancement in relation with fund provider from 'not tight' to 'extremely tight' shows significant ( $\chi^2 = 21.758, p > 0.001$ ) effect on access to formal finance. Looking on 95 percent confidence intervals for the odd ratio, the result indicates that the odd (Exp (B)) of access to formal finance were 2.019 times higher for every improvement in relation with bank (from not tight to extremely Tight).

Furthermore, the likelihood of obtaining loan is significantly increased in the four bank relation categories, resulted in improved in relationship. As a result, there is enough evidence to retain the proposed hypothesis and firm's relation with fund provider plays positively a significant role in obtaining formal credit in the case of Addis Ababa. This result is consistent with empirical studies by Nguyen & Luu (2013), which give great emphasis for relationship with bank or in their own word "networking" as a major factor to obtain finance particularly in the context of firms in developing countries.

**Accounting Records:** the practice of firm's decision to maintain accounting book of records decide firms access to formal finance as discussed previously in the literature review. Regarding this variable before running the regression model it was coded as a dummy variable meaning 1 if the firm maintains book of records and 0 otherwise. Surprisingly, this finding indicates that there is no significant effect by the variable accounting recording on access to formal finance as indicated in the Wald's test result ( $\chi^2 = 0.785, p > 0.05$ ).

Moreover, based on 95 percent confidence intervals for the odd ratio, the odd of access to formal finance were 0.691 times lower for the firms with book of accounts (CI from 0.29 to 1.57). The implication is the likelihood of obtaining loan is not statistically significant due to a firm is being keeping book of records properly. Therefore, the result reveals that there is no enough evidence to accept the proposed hypothesis and it is statistically insignificant in the case of Addis Ababa. Here the reason may be formal financial institutions in Addis Ababa ask financial statement of

enterprises before lending only once. In other words, formal financial institutions didn't ask financial statements of borrowed enterprises continuously after lending.

This finding is against the finding by Nguyen & Luu (2013). According to Nguyen & Luu (2013) accounting record keeping behaviour of enterprises influence access to finance because the likelihood of small firms compared with large firms to obtain formal finance is high and the study reasonout as it is due to good accounting record by large firms.

**Loan necessity:** attitude of SMMEs owner-manager was measured using one proxy that is opinion concerning necessity of loan. This proxy is a dummy variable coded as 1 if they agree with necessity and 0 otherwise. As indicated in the Table 4.13 the Wald's test shows there is no significant effect on access to formal finance ( $\chi^2 = 0.059$ ,  $p > 0.05$ ). Furthermore, based on 95 percent confidence intervals for the odd ratio, the result indicate that the odd of access to formal finance were 1.191 times higher for the firms agree to necessity of loan compared to the reverse (CI from 0.291 to 4.869). The implication is the likelihood of obtaining loan is not statistically significant due to attitude of owner-manager towards external finance.

Therefore, the result reveals that there is no enough evidence to retain the proposed hypothesis and it is statistically positively related whereas it is not significant in the case of Addis Ababa. This result is against the finding by Selamawit et al. (2014) which shows enterprises limit themselves from granting loan just because of their negative attitude towards formal credit.

**Educational Level:** has a statistically significant positive effect on SMMEs access to credit. The Wald's test is evidence for significant effect ( $\chi^2 = 4.608$ ,  $p < 0.05$ ) on access to formal finance and based on 95 percent confidence intervals for the odd ratio, the odd (Exp(B)) of access to formal finance is 1.445 times higher for an improvement in educational level. In other words, the implication here is educated owner-managers are more likely to have access to formal credit than those with low education level or the odds ratio for education is 1.445, implying that one more year of education increases the probability of access to credit by 44.5 percent.

The further analysis clearly implies that, the chance of obtaining loan is significantly increased only in the second educational level that is secondary school level. However, the overall educational level shows that it contribute a lot in obtaining and making things easy in order to

obtain formal loan. In other words, when the educational level of SMME's owner-manager becomes improved, they would get making loan easier and easier. Therefore, it can be concluded as, there is enough evidence to accept the proposed hypothesis, as far as there is positive and statistically significant influence, and educational level determines access to formal finance in the case of Addis Ababa.

This result is consistent with a prior expectation and findings of Selamawit et al. (2014); and Yehuala (2008). Those studies indicate that, education improves the capability for resourcefulness and invention. Contrary, the result is against with Hassen & Abdwahab (2014); and Kofi et al. (2013) findings reasoning as financial institutions don't consider the level of education before granting a loan.

**Age of SMMEs:** assuming other variables constant, the Wald's tests for an increase in firm age shows insignificant ( $\chi^2 = 0.213$ ,  $p > 0.005$ ) effect on access to formal finance. Looking on 95 percent confidence intervals for the odd ratio, the result indicate that the odd (Exp (B)) of access to formal finance were 1.102 times higher for an increase in firms age but not significant. The result in this study shows that, there is a positive and insignificant correlation between ages of the firm and obtaining formal finance.

This result clearly implies that, the chance of obtaining loan is not significant in all categories of firm age. Whereas the trend of odd ratio with respect to firm age is improved simultaneously as the firms age increase and increase. In general, there is no enough evidence to retain the proposed hypothesis and it is statistically positively related whereas it is not significant in the case of Addis Ababa.

Surprisingly, this result is uncommon with previous studies (Beck & Cull, 2014; and Hassen & Abdwahab, 2014). Those studies say that, age of the firm decides the choice of credit finance and their reasons were that associated with information asymmetries regarding small and new enterprises. Similarly, small and new enterprises have no long-term relationship with finance provider and as a result it may be difficult to measure the risk of those small and new enterprises.



# **CHAPTER FIVE**

## **FINDINGS, CONCLUSIONS AND RECOMMENDATION**

This chapter presents the findings, conclusion and recommendations of the results. It has three sections: the first section presents summary of major findings of the study which is directly taken from the data presentation and analysis chapter, the second section presents conclusion about the study area. In this section mainly the researcher opinions were included on the previous major summaries presented as a conclusion. Finally, the last section presents the recommendation part of the study.

### **5.1 Summary of Major Findings**

Based on the Binary Logistic Regression Model which is designed to find out what factors determine access to formal finance in Addis Ababa this study found the following major findings after a detail analysis and interpretation of data in chapter four.

Majority of the respondent who maintain and keep accounting book of records are enterprises haven't a loan. This result implies that even those enterprises not maintaining book of records can get access to finance

Regarding firms relation with credit provider, the survey indicates that majority of enterprises with a loan have an "extreme tight" relationship while majority of the respondents as "no relation" are enterprises without loan.

As per the survey, both enterprises with loan and without a loan have the same perception regarding necessity of formal credit and concerning the highest educational level, majority of respondents have a loan are with preparatory level.

The proportion of enterprises with access to loan increases simultaneously when age of the firm in operation increase. This result indicates difficulty to get a loan at startup is higher and difficulty declines in line with an increase in age of the firm.

Regression output shows that, there is positive and significant relationship between age of owner-managers and the likelihood of obtaining formal finance. This finding show that age of

owner-manager explains access to formal finance. As a result, there is enough evidence to retain the proposed hypothesis and it is statistically positively significant in the case of Addis Ababa.

Firm's relation with fund provider plays positively a significant role in obtaining formal credit in the case of Addis Ababa. As a result, there is enough evidence to retain the proposed hypothesis and it is statistically positively significant in the case of Addis Ababa.

Concerning accounting record, the likelihood of obtaining loan is not statistically significant due to a firm is being keeping book of records properly. Therefore, the result reveals that there is no enough evidence to accept the proposed hypothesis and it is statistically insignificant in the case of Addis Ababa.

The likelihood of obtaining loan is not statistically significant due to attitude of owner-manager towards external finance. As a result, there is no enough evidence to retain the proposed hypothesis and it is statistically positively related but it is not significant in the case of Addis Ababa.

Concerning highest educational level, educated owner-managers are more likely to have access to formal credit than those with low education level. Therefore, there is enough evidence to accept the proposed hypothesis and educational level determines access to formal finance in the case of Addis Ababa.

Regarding firm age, the study finding indicates that, there is no significant relationship between age of the firm and obtaining formal finance. Surprisingly, this result is uncommon and opposite to previous studies. Whatever, there is no enough evidence to retain the proposed hypothesis and it is statistically not significant in the case of Addis Ababa.

## **5.2 Conclusion**

The main purpose of this study was to explain what factors determine access to formal finance in Addis Ababa Administrative City. As presented briefly in the literature review access to loan is crucial for small and medium scale manufacturing enterprises including growth, expansion and acquiring of different operating assets. Similarly the result in this study support this idea that small and medium scale manufacturing enterprises need additional source of finance for acquiring of machineries and for purchase of raw materials which is used in production as an

input. While there are a number of constraints that limit SMMEs from obtaining access to formal credit (finance).

The first major finding of the study indicates that firm's access to credit is explained by age of owner-manager. When a firm manager gets old and old, the likelihood to obtain loan is higher. The second major finding of the study indicates that, SMMEs likelihood of obtaining loan is significantly determined by the firm's relation with credit provider. Those SMMEs who improve their relationship with credit providers could obtain formal loan easily. This shows relationship with bank explains the possibility for access to finance. The third finding of the study indicates that, overall educational level contribute a lot in obtaining and making things easy in order to obtain formal loan. In other words, when the educational level of SMME's owner-manager becomes improved through time, they would get making loan easier and easier. Therefore it can be concluded as; there is enough evidence to accept the proposed hypothesis concerning age of owner-manager, bank relation and educational level of owner manager as explaining factors to obtain formal credit in Addis Ababa Administrative City.

On the other hand, maintaining accounting book of record, attitude towards loan and firms age did not contribute significantly to the model. So, there is no enough evidence to retain the proposed hypothesis and consider as explaining factors to obtain formal finance in Addis Ababa.

### **5.3 Recommendation**

Based on the study result, the researcher would like to forward the following recommendations.

In order to increase SMMEs access to finance, it requires more effort from the Small and Medium Manufacturing Enterprises side to overcome their drawbacks. This includes specific owner-manager personal characteristics such as: extending the highest educational level of owner managers and strengthening their relationship with bank.

SMMEs can strengthen their relationship with bank starting from the easiest one, making payments and receipts using checking accounts up to the difficult one creating long term relationship with credit provides. While the detail of how to strengthen and create relationship with fund providers needs further research.

On the other hand, firms owned or managed by managers with low level of education encounter difficulties to access formal credit from formal financial institutions. Therefore, for SMMEs to improve their access to formal finance there is a need for SMMEs' owner-managers to develop their educational level and where necessary they have to hire educated managers or consultants. Extending educational level is necessary to strengthen the capacity to prepare loan-financed project documentation in order to meet credit provider's requirements (Nguyen & Luu, 2013). Besides, further research is required to determine the methods how to develop highest educational level of SMMEs owner-managers.

## **Further research areas**

In addition to previous recommendations, similar researches should be undertaken on national level, so as to show what factors determine access to formal finance in Ethiopia context. Similarly, if future researches on access to formal finance are undertaken by considering the two sides, demand side and supply side, it will be easy to reconcile mutual interests of both Small and Medium Manufacturing Enterprises and formal credit providers.

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# APPENDICIES

# APPENDICIES

## Appendix I

### English version of questionnaire designed for Small and Medium Manufacturing Enterprises Owner-Manager



Hello, my name is Ahmed Jibrel and I am calling from St. Mary's University. Your business has been selected to participate in a master thesis survey on the financing of Small and Medium Manufacturing Enterprises conducted by me.

Access to finance is crucial to business success and an important factor for economic growth. The purpose of this survey is to examine where there may be constraints on the availability of formal finance (loans), and how those may be changing. This survey is aimed at the Small and Medium-Sized Businesses in Addis Ababa Region. Thanks in advance for your cooperation for the success of the study.

#### How to complete this questionnaire

- ☒ We are looking for the owner(s) or manager(s) of the business to respond.
- ☒ Most of the questions can be completed by placing a tick mark (✓) in the relevant boxes.

### GENERAL CHARACTERISTICS OF THE OWNER-MANAGER AND

#### THE FIRM

1. Gender  Male  Female
2. Age \_\_\_\_\_
3. Age of the firm in terms of year  
 Below 1 year  1-3 year  4-6 year  7 and above
4. Level of education  Primary or Less  Secondary  
 Preparatory  College (university) or above
5. Have you accessed any business Training services?  Yes  No

6. If YES in (5) above, which services have you accessed?

Accounting                       Human resource management  
 Inventory Control               Marketing      Other (Specify) \_\_\_\_\_

7. Do you own businesses other than this one?               Yes     No

8. Form of enterprise

Registered Sole proprietorship  
 Registered Partnership  
 Registered Private Limited Company      Other \_\_\_\_\_

9. How many people do you employ currently in this business?

Female \_\_\_\_\_ Male \_\_\_\_\_

10. Do you have accounting book of records?               Yes               No

11. If your answer in Q10 is “Yes” then the financial records or statements of your business are prepared by:

The in-house finance department of your business  
 A trust company or an external chartered accountant

Other (Specify) \_\_\_\_\_

12. Did you apply for a loan?               Yes               No

13. If your answer in Q12 is “Yes” then why did you not apply? Please tick ( √ ) one and more

Reason for not applying loan	√
No need for a loan	
Application procedures are complex	
Interest rates are not favorable	
Collateral requirements are too high	
Size of loan or maturity are insufficient	
Necessary to make informal payments to get bank loans	
Did not think it would be approved	

14. Do you have a loan?               Yes               No

15. If your answer in Q12 is “Yes” which type of loan do you have and how successful were you in obtaining loan finance from each of the following sources? (*‘Partially successful’*)

refers to not getting the requested amount or not on the desired terms.)

	Applied		Granted		
	Yes	No	Successful	Partially Successful	Unsuccessful
The owner(s)/director(s)					
Other employees of your business					
Family, friends or other individuals outside your business					
Other businesses					
Micro Finance Institution					
Banks (other than MFI)					
Loan from money lenders (“Arata”)					

Please specify the other loan sources \_\_\_\_\_

16. Have you contact with bank officials?  Yes  No

17. If Yes,

A. how many times per month \_\_\_\_\_

B. Please specify for what reason \_\_\_\_\_

18. How do you express your relationship with bank officials?

Not tight     Slightly tight     Tight  
 Very tight     Extremely tight

19. Do you think bank loan is necessary?  Yes  No

20. Do you think loan financing have tax advantage?  Yes  No

21. Do you have a prepared plan for expansion?  Yes  No

22. Right at this moment, do you need any additional finance from external sources?

YES     NO

23. If yes, for what specific purpose do you need it?

Rent     Hiring more People  
 Machinery purchase     Raw material  
 Tax payment

24. If you are asked for collateral to borrow from a bank what kind of collaterals can you present?

- 1.1 Building and land title deed.  Your own  Others
- 1.2 Vehicles ownership certificate.  Your own  Others
- 1.3 Personal guarantee of permanent Employee.  Yes  No
- 1.4 If Yes for Q9.3 how much is the salary? \_\_\_\_\_

25. How significant are each of the following problems for your organization to get bank loan?

	Not problem	Slightly serious	Serious	Very serious	Extremely serious
Amount available is not enough for the intended purpose					
Takes time for approval					
Insufficient collateral or guarantee					
Interest rates or price too high					
Financing not available at all					

Other? Please specify \_\_\_\_\_

## Appendix II

### Amharic version of questionnaire designed for Small and Medium Manufacturing Enterprises Owner-Managers



### የቅድስት ማርያም ዩኒቨርሲቲ የድህረ ምረቃ ትምህርት ክፍል አካውንቲንግ እና ፋይናንስ መርሃ ግብር

ይህ መጠይቅ እና ከመጠይቁ ጋር ተያያዥነት ያላቸው ማንኛውም መረጃዎች ለትምህርታዊ ጥናት ብቻ የሚወጡ ሲሆን የጥናቱ ዋና ዓላማ በቅድስት ማርያም ዩኒቨርሲቲ በአካውንቲንግ እና ፋይናንስ መርሃ ግብር ለምሰራው የድህረ ምረቃ ትምህርት ማሟያ የሚወጡ መሆኑን ለመግለፅ እወዳለሁ።

ጥናቱ የሚያተኩረው በአዲስ አበባ ከተማ ውስጥ በሚገኙ አነስተኛና መካከለኛ አምራች ኢንተረፕራይዞች የገንዘብ (የፋይናንስ) ምንጭ አቅርቦት ውስንነት ዙሪያ ሲሆን ለዚህም የእርስዎ ድርጅት በናሙናነት ከተመረጡት አንዱ ነው። በመሆኑም መጠይቁን በመሙላት ለጥናቱ መሳካት ለሚያበረክቱት ላቅ ያለ ትብብር እና ተሳትፎ በቅድሚያ ምስጋናዬን ለመግለፅ እወዳለሁ።

#### የመጠይቅ አሞላል

- መጠይቁ በስራ አስኪያጅ ወይም በድርጅቱ ባለቤት መሞላት አለበት።
- የመጠይቁን ጥያቄዎች በመረዳት ለምርጫ ከተቀመጡት አማራጮች ውስጥ የ(v) ወይም (X) ምልክት ያድርጉ።

#### ጥያቄዎች

1. የታ  ወንድ  ሴት
2. እድሜ \_\_\_\_\_
3. የድርጅቱ የስራ ላይ ቆይታ በዓመት  
 ከ1 ዓመት በታች  1-3 ዓመት  4-6 ዓመት  ከ7  
 ዓመት በላይ
4. የትምህርት ደረጃ  
 የመጀመሪያ ደረጃ ወይም ከዚያ በታች  ሁለተኛ ደረጃ  
 መሰናዶ ትምህርት  ኮሌጅ (ዩኒቨርሲቲ)
5. የንግድ ስልጠና ወስደው ያውቃሉ?  አዎ  የለም
6. ከላይ በተቁ 5 ለተነሳው ጥያቄ መልስዎ "አዎን" ከሆነ የስልጠናውን ዓይነት ይግለጹ  
 የሂሳብ መዝገብ አያያዝ  የሰው ሀብት አስተዳደር  
 የንብረት ቁጥጥር  የገበያ ጥናት  
 ሌላ (ይጥቀሱ) \_\_\_\_\_
7. ከዚህ ሌላ ድርጅት አለዎት?  አዎ  የለኝም
8. የድርጅቱ አመሰራረት  
 የተመዘገበ የግል ድርጅት  የተመዘገበ የሽርክና ድርጅት  
 የተመዘገበ ሃላፊነቱ የተወሰነ የግል ማህበር ሌላ \_\_\_\_\_
9. በአሁኑ ጊዜ ምን ያህል ሰራተኞች አሉዎት? የወንድ ብዛት \_\_\_\_\_ የሴት ብዛት \_\_\_\_\_
10. የሒሳብ መዝገብ ይይዛሉ?  አዎ  አልይዝም
11. ከላይ በተቁ. 10 መልስዎ "አዎን" ከሆነ የድርጅትዎ የሒሳብ መዝገብና ትንተና  
 የሚዘጋጀው የት ነው?  
 በድርጅቱ የውስጥ ፋይናንስ ክፍል  
 ከውጪ በተመሰከረላቸው የሂሳብ አዋቂዎች  
 ሌላ (ይጠቀስ) \_\_\_\_\_
12. ብድር ለመውሰድ አመልክተው ያውቃሉ?  አዎ  አላወቅም
13. በተቁ 12 መሰረት መልስዎ "አላወቅም" ከሆነ ምክንያትዎን ከዚህ በታች ካሉት  
 አማራጮች ውስጥ ካለ የ (✓) ወይም (X) ምልክት በማድረግ ይግለጹ?

ብድር ያልጠየቁበት ምክንያት	√ ወይም X
ብድር ስለማያስፈልገው	
የብድር ማመልከቻ ሂደት መወሳሰብ	
የወለድ ምጣኔ ምቹ አለመሆን	
ከፍተኛ የሆነ የብድር ማስያዣ መጠየቅ	
የብድር መጠን ወይም የክፍያ ቀን ገደብ ማነስ	
ለብድር ማስፈጸሚያ የሚጠየቁ አላስፈላጊ ክፍያዎች መኖር	
ብድሩ ሊፈቀድልኝ አይችልም ብሎ ማሰብ	
ሌላ ካለ ይግለፁ _____	

14. ከዚህ በፊት ከባንክ ወይም ከሌላ የገንዘብ ተቋማት የወሰዱት ብድር አለብዎት?

አዎ

የለም

15. ከላይ በተ.ቁ. 14 ለተጠየቀው ጥያቄ መልስዎ "አዎ" ከሆነ የቱን ዓይነት ብድር ወስደዋል እንዲሁም ከሚከተሉት የገንዘብ ማግኛ ምንጮች ብድር በማግኘት ረገድ ምን ያህል ውጤታማ ነበሩ?

(ክፍል ወጤታማ የሚያመለክተው የተጠየቀውን ያክል ብድር አለማግኘት ወይም በተፈለገው ሁኔታ አለመሰጠቱን ነው።)

	የተጠየቀ		የፀደቀ		
	አዎ	የለም	ውጤታማ	ከፊል ውጤታማ	ያልተሳካ
ከድርጅቱ ባለቤት(ቶች)					
ከድርጅቱ ሰራተኛ(ኞች)					
ከቤተሰብ፣ ጓደኛ ወይም ሌሎች ከድርጅቱ ውጪ ከሆኑ ግለሰቦች					
ከሌሎች ድርጅቶች					
ከጥቃቅን የፋይናንስ ተቋማት					
ከባንኮች					
ከሌላ አራጣ አበዳሪዎች					



ሌሎች የብድር ምንጮች ካሉ ይጥቀሱ \_\_\_\_\_

16. ከባንክ ሠራተኞች ጋር ቅርብ ግንኙነት አለዎት?  አዎ  የለም

17. ከላይ ለተነሳው ጥያቄ መልስዎ "አዎ" ከሆነ

ሀ. በወር ምን ያህል ጊዜ \_\_\_\_\_.

ለ. ምክንያቱን ይጥቀሱ \_\_\_\_\_

18. ከባንክ ጋር ያለዎትን ግንኙነት እንዴት ይገልፁታል

አነስተኛ ቅርርብ  መጠነኛ ቅርርብ  ጠንካራ ቅርርብ  
 በጣም የጠነከረ ቅርርብ  እጅግ በጣም የጠነከረ ቅርርብ

19. የባንክ ብድር ለንግድ ስራ መሳለጥ አስፈላጊ ነው ብለው ያምናሉ?

አዎ  የለም

20. በብዛት ብድር ወስዶ መጠቀም ከሚያስገኙት ጥቅሞች አንዱ የገቢ ግብር የክፍያ

መጠንን እንዲቀንስ ማስቻል ነው ብለው ያስባሉ?  አዎ  የለም

21. ስራዎን ለማስፋፋት የተዘጋጀ እቅድ አለዎት?  አለኝ  የለኝም

22. በአሁኑ ጊዜ ለንግድ ስራዎ ተጨማሪ ገንዘብ ከውጪ ምንጭ ያስፈልጎታል?

ያስፈልገኛል  አያስፈልግም

23. ከላይ በተ. ቁ. 22 ለተነሳው ጥያቄ መልስዎ "አዎ" ከሆነ ምክንያት የሚሉትን ይምረጡ

ለኪራይ ክፍያ  ተጨማሪ ሰራተኛ ቅጥር ክፍያ  
 ማሸነፊ ግዥ  ጥሬ ዕቃ ግዥ  
 የግብር ክፍያ

24. ከባንክ ብድር በሚወስዱበት ወቅት ማስያዣ ቢጠየቁ የትኛውን ማስያዣ ማቅረብ ይችላሉ?

24.1 የህንፃና መሬት ባለቤትነት ሰነድ  የግል  የሌላ

24.2 የተሽከርካሪ ባለቤትነት ሰነድ  የግል  የሌላ

24.3 የሌላ ሰው የደመዎዝ ገቢን እንደማስያዣ

24.4 መልስዎ በተ.ቁ. 24.3 ላይ ላለው አዎ ከሆነ ምን ያክል የደመወዝ መጠን ያቀርባሉ \_\_\_\_\_

25. የባንክ ብድር ከማግኘት ረገድ የሚከተሉት ችግሮች በድርጅት ውስጥ ካሉ ምን ያህል አሳሳቢ ናቸው?

የችግር አይነት	አሳሳቢ አይደለም	በትንሹ አሳሳቢ	አሳሳቢ	በጣም አሳሳቢ	እጅግ በጣም አሳሳቢ
የሚቀርበው ብድር ለታለመለት ዓላማ በቂ አለመሆን					
ብድር ለማጽደቅ የሚወስደው ጊዜ ረጅም መሆን					
የዋስ ወይም ማስያዣ እጥረት					
የወለድ ምጣኔ ከፍተኛ መሆን					
በአጠቃላይ የፋይናንስ አቅርቦት አለመኖር					

ሌሎች? እባክዎን ይጥቀሱ \_\_\_\_\_

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