ST MAR'Y UNIVERSITY

SCHOOL OF GRADUATE STUDIES

THE FINANCING OPTIONS FOR MICRO AND SMALL ENTERPRISES FROM INCEPTION TO OPERATION IN ETHIOPIA

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SGS/0054/2008A

MAY 2018

ADDIS ABABA, ETHIOPIA

THE FINANCING OPTIONS FOR MICRO AND SMALL ENTERPRISES FROM INCEPTION TO OPERATION IN ETHIOPIA

A thesis submitted to School of Graduate Studies

(MBA IN GENERRAL)

ST. MERY UNIVERSITY

In partial fulfillment of the requirements for the Degree of Master in Business Administration

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MAY 2018

ADDIS ABABA, ETHIOPIA

APPROVAL SHEET

As members of board of examining of the final MSc thesis open defense, we certify that we have read and evaluated the thesis prepared by Selome Mekonnen Tessema under the title "**THE FINANCING OPTIONS FOR MICRO AND SMALL ENTERPRISES FROM INCEPTION TO OPERATION IN ETHIOPIA**" we recommend that this thesis to be accepted as fulfilling the thesis requirement for the Degree of Master in Business Administration.

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Dedication

I would like to dedicate this Master Thesis to My Son Kenean the great.

DECLARATION

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

Declared By:

Name: ___________________

Signature: ______________________

Date: _________________________

Place and date of Submission______________________________

ENDORSEMENT

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

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Advisor Signature

St. Mary's University, Addis Ababa May 2018

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Acknowledgements

First and for most, I would like to express my sincere thanks to ALMIGHTY GOD and HIS HOLY MOTHER St. MARRY, who helped me in all aspect of my life.

I would also like to convey my heartfelt appreciation and deepest gratitude to my advisor, Zinegnawu Abiy (PhD) for his invaluable comments, encouragements and expert guidance at various stage of the study.

List of Abbreviations

BDS	Business Development Service
ETW	Entrepreneurship Training Workshop
FeMSEDA	Federal Micro and Small Enterprise Development Agency
MFIs	Micro Financial Institutions
MM	Modigliani and Miller
MSEs	Micro and Small Enterprises
NBE	National Bank of Ethiopia
R&D	Research and Design
ReMSEDA	Regional Micro and Small Enterprise Development Agency
SMEs	Small and Medium Enterprises
SPSS	Statistical Package for Social Scientist
UNDP	United Nations Development Program

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Abstract

This thesis examines the financing options for Micro and Small Enterprises (MSEs) from inception to operation in Ethiopia. The study focuses on describing sources of finance that had been accessed by MSEs, and examines the extent to which MSEs fulfill requirements that are put up by commercial banks, micro-finance institutions, and angel investors to access finance.

In tackling this topic, a mixed research approach design was adopted. Specifically, the study uses survey of 384MSEs from Addis Ababa, Amhara, Oromiya, SNNPR, Tigray, Harare and Somalia regions and 108 potential angel investors, and in-depth interviews with two bank managers and two micro finance institution loan officers. Survey data were quantitatively analyzed through descriptive statistics and the interview results were thematically analyzed.

Results show that MSEs found under study frequently accessed finance from personal and partner's savings, loan from family and friends, Iqub and micro financial institutions and commercial banks in that order. While the current source of finance for MSEs are Iqub, personal and partners' contribution, loan from families and friends, micro finance institutions and commercial banks, in order. Specifically, lack of collateral, bad previous record and high interest rate become the obstacle factors for MSEs to use commercial banks and micro finance institutions as source of finance. While these obstacle factors to be at the lowest level while using angel capital market ownership, availability and exiting route (liquidity) were identified as the obstacle factors. Further, it identifies that the practice of accessing finance from the new alternative and innovative source of finance: angel capital market is more accessible than the existing and traditional sources of finance: commercial banks and micro financial institutions to MSEs from inception to operation in Ethiopia.

Finally, the thesis recommends a serious of measures which should be performed by the policy makers and stakeholders. These include for supply side: designing and implementing effective regulatory framework to address lack of liquidity, mix of policy instruments and training on skills, mentoring and coaching while for demand side to launch investment readiness programs.

Key words: Financing Options, Sources of finance, MSEs, Ethiopia

Chapter One

1. Introduction

1.1 Background of the Study

There is a growing attention toward the role of Micro and Small Enterprises (MSEs) for their contribution for economic growth, job creation and poverty reduction in developing countries. Micro and Small Enterprises (MSEs) sector is described as the conducive environment for the flourishment of entrepreneurship. MSEs have the potential to provide the ideal environment for enabling entrepreneurs to optimally exercise their talents and to attain their personal and professional goals. MSEs are essential springboard for growth, job creation, and poverty reduction (Ngui, 2014). Due to the shared understanding, Ethiopia has prioritized MSEs development for the achievement of their contribution (Mekonnen & Tilaye, 2013).

To lead and stir the development of Ethiopian MSEs, Federal Micro and Small Enterprises Development Agency (FeMSEDA) is established since 1997 EC., followed by the Regional Micro and Small Enterprises Development Agency (ReMSEDA) to reach out regionally located MSEs. The primary objective of FeMSEDA is to create favorable environment for MSEs so that MSEs could facilitate economic growth, create long-term jobs, strengthen cooperation between MSEs, provide the basis for medium and large-scale enterprises and promote export. Direct policy support to MSE development is one of the favorable environments that the Ethiopia's government has showed commitment. Among the direct supports, access to finance is one (Berihu et al., 2014)

Access to finance is important for idea level, Start-up s and existing MSEs to fulfill the above-mentioned role that they play for economic growth. Adequate access to finance is one of the biggest challenges to MSEs in Ethiopia. Lack of access to finance does not only hinder the birth, growth and expansion of MSEs but also inhibit the economic growth of the country by depriving the opportunity of economic growth that might promote job creation and poverty reduction (Dean et al., 2012). Study conducted by Simeon & Lara (2005) for USAID, also shows that lack of access to finance is widely accepted as a major obstacle to MSE growth. Given the important role that MSEs is believed to play in the process of economic growth it is crucial to attempt to alleviate financial constraints.

To alleviate financial constraints MSEs access finance from the existing and traditional source of finance. For addressing micro and small businesses, Micro financial institutions and commercial banks are the existing and traditional sources of finance in Ethiopia. Entrepreneurs who are at idea level, Start-up s and existing ones face tremendous challenges to secure loan from these financial institutions. The major factors that inhibit small businesses to access finance are lack of collateral and in ability to generate quality financial report, transactional cost and risk associated with the early stage of the businesses from the Banking industry side (John & Sylvester, 2011)

In Ethiopia the financial system is dominated by banking industry, and yet, it is amongst the major under-banked economy in the world (Zerayehu et al., 2013). Given the important role that entrepreneurship is believed to play in the process of economic growth it is crucial to attempt to alleviate financial constraints for idea level, Start-up s and existing businesses. Entrepreneurs found at idea, start up and existing level faces the constraint of finance from the existing and traditional source of finance. As per the study conducted, young firms with little experience and inadequate collateral suffer most as far as access to finance is concerned (Fredu and Edris, 2016).

In order to address the lack of appropriate source of finance for idea level, Start-up s and existing MSEs in Ethiopia, this study will examine alternative, new and innovative financing options that should be available and appropriate.

1.2 Statement of the Problem

Access to finance is crucial for MSEs at all level: idea, start up and existing. Access to finance is one of the major constraints that MSEs face in developing countries (Matteo et al., 2016). Ethiopia’s MSEs found at idea, Start-up and existing level are also subjected to lack of access to finance in predominant manner (Firewoini, 2016). According to Fredu & Hussein (2016) study, the sector, micro and small enterprise, is impeded by constraints of access to finance, electricity and land are the first three accordingly ranked constraints (Fredu & Hussein, 2016).

MSEs commonly use equity and debt sources of financing that are available for them (Lucia, 2015). Under the private equity finance personal resources, business angels, venture capital, and joint venture are found (John & Sylvester, 2011). Yet among the mentioned scheme the one that is practiced in Ethiopia is the personal resources, sources that are accessed through personal savings of the owners and partners of MSEs. This practice of financing their business from their own source mounted 79% for Micro enterprises while 72% for medium enterprises (Solomon et al., 2016). However, the finance obtained from the saving won't be enough and will call for the second type of finance debt financing (Mekonnen & Tilaye, 2013)

Debt financing, the second type, is financing type that a business can get finance with a contractual claim on the firm. The sources of finance to access debt financing by MSEs at all level in Ethiopia are mainly provided by commercial banks, microfinance institutions and development bank in Ethiopia (Dereje, 2012). The institutions' provision of finance is mainly based on the fulfillment of prepared financial information and collateral requirements (John & Sylvester, 2011). The repeatedly mentioned challenges that are inherited with the character of these MSEs are inability to produce quality financial information. Lack of education of the owner manager, of the MSEs contributes to the inability of preparing quality financial report that will exhibit the business's activities to the institutions which is important to show the business's capacity to pay back the requested amount of money (Mekonnen &Tilaye, 2013)

The other factor that inhibits MSEs to access finance from these institutions is collateral requirement. The required collateral won't be available within MSEs, since their available capital amount is the one that put them under MES in the first place. It is clear that due to MSEs are unable to provide the required collateral they will not use the service that is rendered by financial institutions in result that they can't use the existing, available and traditional source of finance. And this causes financial gap (Hezron & Hilario, 2016). This fact, caused financial gap, is the other worth searching new innovative alternative source of finance for MSEs in Ethiopia.

Financial gap created by the requirements of firm's business information, capacity, and firm's collateral is also aggravated by capital, condition and character of the business that make MSEs thundered by not accessing the available source of finance (Alex & Zhongzhi, 2012). Financial gap still exists between the supply capabilities and the demand needs which calls for a market to exist to fill this gap by bringing potential source of finance into the picture that has the capabilities to supply finance. This demand for innovative source of finance that MSEs found in Ethiopia can access.

Among the sub topic that have been studied related to MSEs are shortage of finance, obstacles and remedies for the lack of access are under finance. The followings are some studies that tried to show the existence of the shortage of finance and the obstacles followed by the remedies they recommend for MSEs in Ethiopia. Mekonnen & Tilaye (2013) on their study showed inadequate finance as a problem for MSEs in Ethiopia. While Vijay & Gebresilassie (2015) put as one of the hurdles for MSEs is lack of access to capital, although FEMSEDA recognized that MSEs have a problem of finance (FeMSEDA, 2013) and among the list of key constraints to MSE growth is access to finance is listed as the first on their study (Berihu et al., 2014).

Vijay & Gebreselassie (2015) put on their study that the shortage of finance caused by inability of entrepreneurs to meet the requirements of financial institutions like proposals of business plan, documentation of financial requirements and other liability issues. High administrative costs, high collateral requirements and lack of experience within financial intermediaries are mentioned as obstacles to access finance by MSEs in Ethiopia (Berihu et al., 2014, Amit et al., 2011).

Dereje (2012) recommends on his thesis creation of a level playing field, lowering transactional costs, while FeMSEDA recommended strengthen the provision of credit (FeMSEDA, 2013), and has designed a national micro credit and saving directive that primarily focuses on alleviating financial constraints of MSEs operating in the country (Berihu et al., 2014) while the other point forwarded was provision of technical assistance (Amit et al., 2011).

However, as per the knowledge of the researcher, looking for another option as a source of finance was not undertaken to study in Ethiopia. This literature gap is also considered as part of the problem that needs to be stated and started to be studied.

1.3 **Basic Research questions**

The study is based on the fact that there is an existence of financial gap that is created by lack of appropriate source of finance for MSEs. Hence this paper intends to examine the availability of another innovative source of finance for MSEs in Ethiopia. In order to fulfill this aim, to examine whether the new innovative source of financing option can be another preferred source of finance for idea level, Start-up s and existing MSEs in Ethiopia, the following questions are set as guidelines:

- How do commercial banks rate MSEs applicants to use them as source of finance in Ethiopia?
- How do microfinance institutions rate MSEs applicants to use them as source of finance in Ethiopia?
- How do potential angel investors rate MSEs applicants to use them as source of finance in Ethiopia?
- How do MSEs prefer commercial banks as source of finance from micro financial institutions and potential angel investors?
- How do MSEs prefer micro financial institutions as source of finance from commercial banks and potential angel investors?
- How do MSEs prefer Potential angel investors as sources of finance from commercial banks and micro financial institutions?

1.4 Objectives of The Study

1.4.1 General Objective

The objective of the study is to examine angel capital market can be alternative source of finance for idea level, Start-up s and existing MSEs in Ethiopia.

1.4.2 Specific objectives

- To describe the previously accessed sources of finance by MSEs,
- To describe the current sources of finance being accessed by MSEs,
- To describe the future usage of sources of finance by MSEs,
- To examine the extent to which MSEs fulfil 5C's (collateral, capacity, capital, condition, character), documentation, proposal and interest rate requirements that commercial banks put upfront for accessing finance in Ethiopia,
- To examine the extent to which MSEs fulfil 5C's (collateral, capacity, capital, condition, character), documentation, proposal and interest rate requirements that micro financial institutions put upfront for accessing finance in Ethiopia,
- To examine the extent to which MSEs fulfil the trustworthiness, collateral, management team, perceived financial reward and potential exit routes (liquidity) requirements that potential angel investors put upfront for accessing finance in Ethiopia.

1.5 **Significance of the study**

This study is assumed to be conducted for the following significant expectation.

Contribution to policy

The study could help policymakers

- to develop ways to enhance the growth of entrepreneurship in Ethiopia,
- to make decisions how to influence angel capital market, and
- To use it as input to initiate and provide a regulatory frame work to enable the instrument safely practices.

Contribution to the literature

Since the recognition of MSEs importance in economic growth, studies have been focused on this sector heavily. Among the sub topic that have been studied related to MSEs are shortage of finance, obstacles and remedies for the lack of access are under finance. However, as per the knowledge of the researcher, looking for another option as a source of finance was not undertaken to study in Ethiopia. This study will have significance in contributing to this effort and also provides insight for further study in the subject under consideration. And the other contribution is the finding of new alternative source of finance that lets MSEs to access finance.

Contribution to stakeholders

To stakeholders that are working on MSEs in any aspect, the study brings a new perspective how stakeholders tailor their service to fit their support to MSEs in order them to access finance from alternative source of finance.

Contribution to potential angel investors

The study provides treasured awareness generally to the society and specifically for those who are earning more than their expenditure from their professional endeavor about the practice of angel investment.

1.6 **Delimitation of the Study**

The scope of this research regarding to the definition of the total population of MSEs is limited to only those who attended and completed the six days Entrepreneurship Training Workshop

(ETW) and Business Development Service (BDS) given by Entrepreneurship Development Center (EDC) of Ethiopia which is under FeMSEDA. The reason for concentrating on MSEs that took training is to avoid the effect of other constraint, which is lack of training on entrepreneurial competency, that contribute to MSEs inability to play their role. Geographically the study considered Addis Ababa, Amhara, Oromiya, SNNPR, Tigray, Harar and Somalia regions, since it is only in these regions that FEMSEDA facilitates ETW through EDC. Methodologically the study employed mixed approach and to analyze descriptive approach with the guided by deductive rule and specifically, while analyzing frequency and percentage were used.

1.7 **Organization of the paper**

The remaining part of the research report has been organized as follows. Chapter two contains review different literatures written in the areas of MSEs, entrepreneurship, existing traditional and formal source of finances, new and innovative source of finance. The research methodology is presented in chapter three. Chapter four presents the results of the different methods used and analysis. Finally, chapter five presents summary of major findings, conclusions of findings and recommendations for the concerned bodies.

1.8 **Limitation of the Study**

As a research this thesis is not without limitations and exhaustive. Thus, this section briefly discusses these limitations and indicates possible future research directions.

The major limitation of this study is the fact that only potential and individual angel investors were surveyed. Considering potential and individual angels may be a good sample for predicting the criteria that the Ethiopian potential and individual angel population for the current situation where there is no real angel investment taking place in the country however, extending the survey to active individual organized angel investors would increase the power of the study. This limitation has impact on some of the research recommendations to be practical only until the introduction of the instrument. The other limitation that worth being mentioned is being the focus of the thesis is on single segment of the economy i.e. MSE is another limitation.

Chapter Two

2. Literature Review

This chapter is devoted to review the theoretical and empirical literature on the financing options for MSEs from inception to operation in Ethiopia. This review of the literature establishes the outline for the current study and provides the gap of the previous studies, which in turn, help in clearly identifying the gap in the literature and formulating research objective for the study.

The review has three sections. The first one will be dealing with the theoretical review of the financing options for MSEs from inception to operation followed by the relevant empirical studies. And finally, the third part will serve conclusions and knowledge gaps.

2.1. Theoretical Literature Review

This sub section briefly sketches different types of capital structures which have proven effective theories in business world. The section starts with an overview of capital structures and explains the theoretical option of sources of finance for MSEs. These give an idea on financing options for MSEs from inception to operation. Finally, the concern is to show the nature and measures of criteria employed from both the available and traditional sources and the alternative and innovative sources of finance that create obstacle to access finance from to SMEs.

2.1.1. Information Asymmetry Theory

Information Asymmetry Theory was used to study decisions in transactions where one party has more or better information than the others. Information asymmetry theory hypothesizes that when parties are making decisions, transactions and trading, one party is more informed or has better information than the others. Imbalance of power among parties will occur due to the information asymmetry (Demsetz,1968)

2.1.2. Agency theory

Agency theory explains about a problem which is known as collectively principal-gent problem which arises between shareholders, managers and lenders (Jensen & Meckling, 1976). When mangers are not performing to attain the shareholders' value maximization goal, shareholders incur costs to monitor managers consecutively it influences managers' action in which managers have to make viable decisions for the prosperity of the firm at this point the conflict between stockholders and managers arise. In contrast, lenders are united with the shareholders in requesting firm's performance, but when firm face difficulties this unity of the purpose can collapse. The shared goal of the combination between lenders and shareholders is to take several necessary measures to rescue the firm. These conflicts will never happen if all stake holders have the same information which is rarely happen in finance which is called information asymmetry. The presence of information asymmetries impacts these different parties on their decisions.

2.1.3. Adverse selection

When the information asymmetry happens before the parties get into agreement the situation refers to as adverse selection. With this situation in mind, menu of contract will be offered to the agents that lead to self-selection and revealing their private information which in return will segment the market by itself. To address the imbalance of power caused by the information asymmetry, banks screen their customers with the use of collateral requirements (Rothschild & Stiglitz, 1976).

2.1.4. Moral hazard

On the contrary, the situation which the information asymmetry happens after the agreement is obtained is called moral hazard. The principal - agent problem is often used to analyze the moral hazard situation. Moral hazard situations imply that every agent is given the same contract; the contract must therefore consider future information asymmetries, and hence address the incentives problem (Mirrlees, 1999).

As applied to my study, this theory holds that collateral, capacity, capital, character and condition to influence access to finance from debt and trustworthiness of business owner(s), having collateral, management team, Perceived financial rewards (for investors), size of the investment and potential exit routes (liquidity) to influence access to finance from equity source of finance.

2.1.5. Peaking order theory

Access to finance and their by capital structure of SMEs is impacted by asymmetric information and moral hazards by the presence of agency problem (Stiglitz & Weiss, 1981). Myers (1984) stipulated that the pecking order theory states that the presence of asymmetries of information among the stakeholders; most firms utilize in optimal internal sources available to finance their investments before opting to use debt and equity. The existence of adverse selection problem that hinder MSEs access to credit and it's expensive to solve the problem MSEs face challenges in making decision of financing choices. SMEs' finance their investment opportunities by issuing stock (stock market). SMEs operators may decide to finance their investment by using either internal or external sources; when external source is priority the least risk should be selected.

2.1.6. Traditional tradeoff theories

Traditional tradeoff theories point out that evaluating bankruptcy and agency costs of debt, tax saving available in debt and equity based on available information have to be computed to reach a firm to optimal capital structure option. The firm's value will be maximized if the firm attains its optimal debt in its capital structure by minimizes the cost of capital. Frelinghaus et al., 2005 explain on their study despite of financial distress problem exists when firm imply debt financing in its capital structure; MSEs imply debt as the only choice available due to insufficiency of internal sources and unavailability of equity finance.

2.1.7. Capital structure

On Gitman (2003) and Brealey et al (2001) studies it is state that when a firm uses a mix of debt and equity to finance its operations the phenomenon described as capital structure. Capital structure is hypothesized originally from Modigliani-Miller theory, which argued when the perfect market exists the value of the firm is irrelevant in financing decisions (Modigliani & Miller, 1958, 1963). Since the theory is inapplicable in the real world, while the firm's value is relevant in financing decision due to tax components, information asymmetry, bankruptcy costs and agency costs that influence firm's capital structure. When a firm engages debt in a firm's capital structure, the interest on debt which is subjected to tax-deductibility will benefit the firm, thus create tax savings for the borrower (Modigliani & Miller, 1963). Consequently, reduction of firm's costs of capital and maximization of shareholders' wealth become possible by engaging debt. Engaging debt financing due to tax saving makes it cheaper than equity financing wherever employed in a firm's capital structure.

Using the combination of inexpensive debt with relatively expensive capital equity will decrease cost of capital for the firm, which is the obstacle rate for investment acceptance or rejections. If the project can generate a cash flow which is able to cover the initial cost of the investment it will be pursued. MM theory stipulated that a firm should have 100% debt in its capital structure in order for a firm to enjoy the tax shield benefit (Miller & Modigliani, 1963). Because of the existence of financial distress costs, theoretically 100% tax shield doesn't exist (Scote, 1972; Kraus & Litzenberger, 1973). Settling obligation including interest and principal are the cost attached to a firm by utilizing debt financing. If a firm fails to meet these legal obligations will lead it to encounter liquidation and suffer the related settlement expenses.

The purposes of this section are to present an overview of the financing options for SMEs from inception to operation the remaining sections briefly reviews the criteria from traditional sources of finance namely commercial banks and micro finance institutions and from alternative sources of finance namely angel investors respectively.

2.1.8. Traditional source of finance: Commercial banks and MFI

Traditionally, to assess the creditworthiness of small businesses borrowers apply basic lending principles such as the 5Cs namely character, capacity, capital, collateral and condition. 5c's are used in banks as methods to consider a loan request.

Capacity: ability of the borrower to repay the loan

The need to check of a business for its capacity in the process of considering the loan request is to find out the ability of the MSE to repay the loan. It is done by extracting information from the submitted financial information. Using performance factor of Net Profit Margin, Debt Service Coverage Ratio and Quick Ration the lender can predict the MSEs' Capacity (Kabir et al., 2010) And It is calculated by comparing cash generated to pay the loan.

Character: personality of the borrower

The need to check for a borrower's firm management character is to assess the moral and human factor of the business ethics, commitment and responsibility (Kabir et al., 2010). And it refers to the evaluation of the borrower's firm management personality. To check the integrity and trustworthy of a firm this assessment is performed (Abbadi & Karsh, 2013). Honesty in keeping payment schedule is detected from their past borrowing records.

<u>Capital:</u> personality of the borrower

The need to check for a borrower's firm capacity is to determine the borrowers' risk to an unexpected loss in the industry. A firm with high equity is capable of covering all expenses to ensure profitability if not the break-even (Striscek, 2000). On Naradiva & Azlina (2016) study Equity ratio and debt to equity ratio is depicted to show commitment and confidence in a business by capital as in ownership.

<u>Collateral:</u> security made available to secure the loan

The need to check for a borrower's firm collateral is to secure alternative source for the loan repayment in case of failures (Wilkinson, 2013). Collateral refers to the security that the borrower firm made available to access finance and its quality is assessed by using loan-to-value ratio. This security should have proper title, marketable and valuable enough to cover the loan amount (Sharma & Kaira, 2015).

<u>Condition:</u> conditions of the industry, economy and political environment

The need to check for a condition is to ascertain the borrower's vulnerability to happenings in the economy (Moti, 2012). Any external hindrance that will hamper the loan repayment is measured through the analysis of condition. A fair study of the condition of the industry that the firm at, economy and political environment have to be done before loan is approved and disturbed.

Ulrich & Arlow (1981) study reports that collateral, guarantee, maturity and schedule of repayment are important criteria that bankers to accept or reject a small business loan. While Jones (1982) puts collateral, credit history, initial capital, managerial experience and bank policy as criteria by lenders.

2.1.9. Alternative sources of finance: Angel capital market

Alternative sources of finance are available through developing and financing and fund-raising are vital for most new SMEs (Timmons & Spinelli, 2007). Access to finance from family members is guarded by ties of blood and marriage, and is therefore only available to other family members. Accordingly, it does not constitute a market. If a business person is unfortunate enough to come from penurious family then family as a source of potential funding is not feasible to them. However, angel investors do provide finance to businesses that are owned and managed by non-relatives, for this reason angel market is appropriate for anyone who is in business to look for finance from this source. Certainly, business angels establish the largest pool of equity capital available for start-up and emerging companies in advanced economies (Gaston, 1989a).

Angel investors are conventionally defined as high net worth individuals who invest their own money, along with their time and expertises, directly in unquoted companies in which they have no family connection, in the hope of financial gain (Colin, 2005). The emergence of informal venture capital as a distinct topic within the entrepreneurship literature is relatively recent. USA took the lead to have some pioneering studies regarding to establish its importance during the 1980s by Wetzel (1981; 1983; 1986) followed by Tymes & Krasner (1983), Haar et al., (1988) and Gaston (1989b). Later studies in Canada by Riding & Short (1989) and in Europe by Harrison and Mason (1992a), Landström (1993), Mason & Harrison (1994) reveal the importance and practice of angel investment in their geographical areas. Asia also confirmed the existence of angel investment through the studies conducted by Tashiro (1999), Hindle & Lee (2002).

The first generation, the above pioneers of the angel investment studies focus on generating insights into the characteristics of angel investors and their investment activities (Weltzel, 1986). In contrast, the second generation focused on the investment process (Mason & Harrison, 2000a).

Successful business owners anticipate the asset and operating needs so that to evaluate, select, negotiate, and craft business relationships with potential funding sources appropriately (Winton & Yerramilli, 2008). Lack of physical resources is a critical failure factor for new SMEs because opportunity discovery needs physical resources to bring it to fruition (Zhou et al., 2008)

The investment processes

Tyebjee & Bruno (1984) and Fried & Hisrich (1994) studies reveal the investment process of angel investment has similarity with the decision-making model of the formal and external institutional source of finance. Riding et al., (1993) and Hainers et al., (2003) discrete the first stage of angel investment decision is deal origination, the second, deal evaluation into two phases namely initial and detail evaluation, the third, negotiation and contracting, the fourth, post-investment involvement and the final stage is harvesting.

Deal origination

Many studies indicate angel investors adopt ad hoc approach to identify investment opportunities. Most investments start from chance happenstances (Atkin & Esiri, 1993). The angel investors become aware of the availability of the investment opportunity through personal search, approaches from entrepreneurs, referral from business associates, friends, professional contacts like accountants and layers and information in the media (Mason & Harrison, 1994). Contact from business associates takes the most significant sources of deal flow (Colin, 2005). However, the degree to end up at investment successfully differs from source to source. The ones that have the highest probability of leading to investments are investment opportunities got from informal personal sources of information, business associates, friends and approaches from entrepreneurs whereas non-personal sources such as accountants and lawyers have a low likelihood of generating investment (Colin, 2005).

Deal evaluation:

After the investment opportunity came into the horizon of the angel investors screening will precede in two stages. The first stage is initial screening followed by detailed evaluation in due diligence (Riding et al., 1993)

Initial screening:

Mason & Rogers (1997) in their study reveals that the first stage of the evaluation is on assessing for angel investors 'fit' with their own personal investment criteria like:

- Location (how close to home?)
- The nature of the business,
- The amount needed,
- Do I know anything about this industry, market or technology?
- Can I add any value to this business?

If angels find the investment opportunity within their investment criteria they expect a business plan. At this stage of the decision-making process, angels will not go to details of the business plan but just to assess whether the proposal has sufficient value to validate the investment time and to undertake detail assessment (Colin, 2005).

Detail investigation:

The purpose of the initial screen is to filter out "no hopers" in order to focus their time on those opportunities that appear to have potential. These are subject to more detail appraisal. This stage which is subjected of a detail analysis by Manson & Roger (1996; 1997) will focus on the market and entrepreneur rather the product/service and financial factors to make the investment decision. Definitely, angels reveal considerable uncertainty about the value of financial information in the business plan of start-ups: since financial projections can tweak by accountants to come up with any figure (Manson & Roger, 1996). Nevertheless, angels want to make sure that there is the potential for significant financial return and what the money that is invested will be used for (Feeney et al., 1999).

Osnabrugge & Robinson (2000) study supports that the entrepreneur is the most important factor when evaluating a Start-up. 'People' as a factor becomes critical for angel investors once the investment opportunity has passed the initial screening stage (Riding et al., 1995). Under the 'people' factor the angel investors' emphases on

- Management abilities,
- an understanding of what is required to be successful,
- strong work ethic,
- Integrity,
- honest,
- openness, and
- Personal chemistry (Haines et al., 2003; Mason & Stark, 2004).

This stage, deal evaluation, ends based on the decision that the angel investor has reached on the need to negotiate or not. Feeney et al., (1999) highlighted the common short comes of investment opportunity under the management are lack of management knowledge, lack of realistic expectations and personal qualities while, poor management team, poor profit potential for the level of risk, poor fit, undercapitalized/lack of liquidity, and insufficient information are put under the business aspect.

Essential factors that promoted angel investors to invest under the management attributes are track record, realism and integrity and openness while business attributes are potential for high profit, an exit plan, security on their investment and involvement of the investor (Feeney et al., 1999)

For angel investors criteria are personal to assess investment proposal and make decision however, angel investors consider management ability, growth and profit potential to make the decision to invest or not (Colin, 2005). The decision processes of more experienced investors differ from that of less experienced investors (Feeney et al., 1999).

Negotiation and contracting:

After the decision is made on investing on investment opportunity, terms and condition of investment which are accepted by both parties will be set. The three most common issues that needs clear understanding by both parties are valuation, structuring of the deal (share price, types of shares, size of shareholding and timing) and investors role (Colin, 2005).

Riding et al., (1993) study puts in appropriate valuation of their investment opportunity by the entrepreneurs caused half of them not to consummate. In the eye of most angel investors potential entrepreneurs over value their business idea and under value the financial and non-financial contributions that are necessary for the business to become reality (Haines et al, 2003).

Post-investment involvement:

Angel investors play number of roles in their investee business. Advice about the management of the business, contacts, ands-on assistants, providing business and marketing intelligence, are among the number of roles that angel investors play as per Madill et al., (2005) study. Sørheim (2003) stresses that helping their investee business to raise additional finance is among the other activities that angels involve at the time of post-investment.

The motivation of post-investment involvement is not by monitoring considerations rather it is in the form of fun and satisfaction with the thought of their experience, know-how and insights can make a difference (May & Simmons, 2001). Haines et al., (2003) read as angels see themselves as offering help than checking up on their investee business by acting as mentors, providing contacts, guidance and hands-on assistant.

Ehrlich et al., (1994) reports that entrepreneurs want their angel investors to be more involved in financial management. More over the finance that is raised from the angels, the entrepreneurs expect from their investors involvement in the area of marketing and product development (Lengyel & Gulliford, 1997). The study conducted by Osnabrugge & Robinson (2000) shows that 75 to 83 percent of angel investors have entrepreneurial experience.

Osnabrugge & Robinson (2000) study also comment that angels often work with their investee to help them through challenging issues.

Finally, both the investors and entrepreneurs enjoy the relation during the post-investment involvement as long as trade is happening.

Harvesting:

Investing in Start-up businesses is regarded as being high risk. Investments made on early stage of a business have much lower rates of return than those of which invest on later stage of a business (EVCA, 2005). Diversification is one of the strategies that is advised to reduce risk. Since angel investors restrict their investment to sectors which they already know, as we saw above, diversification cannot help as a strategy here. Angel investors are vulnerable to being weakened in the event of required further finance.

Manson and Harrison (2004b) study identified large investments, large deal sizes and deals involving multiple investors as being more likely to be high performing investment.

2.1.10. Conceptual Definition of terms

Micro and small enterprises

Internationally the MSE abbreviation is used for Micro and Small enterprises however, when it comes to defining the term MSE, views differ. For this paper the researcher shares the FeMSEDA's current MSE definition, which is tabulated as follow.

Table 1.1: The current definition of MSEs in Ethiopia

Level of the enterprise	Sector	Human power	Total Asset (Birr)
Micro enterprise	Industry	≤ 5	≤ 100,000
	Service	≤ 5	≤ 50,000
Small enterprise	Industry	6 – 30	≤ 1,500,000
	Service	6 – 30	≤ 500,000

Source: FeMSEDA

The previous (1998) definition of MSE was based on paid capital only. Since employment and asset ownership were not part of the definition it doesn't provide information on job creation, size and asset base. To address these limitations the current (2010/2011) definition considers human capital, asset and sector as the main measures as it is seen on table 1.1

The other ambiguous terms which are commonly mentioned together with MSE are idea level, Start-up level and existing level MSEs. With the current condition and context of the country these terms are carrying the corresponding meaning as follow in this study.

Idea level MSEs are businesses that are at idea level of the entrepreneur/s and do have neither license nor started operation.

Start-up level MSEs are enterprises who are licensed and start operating business with an age not more than two years.

Existing MSEs are enterprises that have been licensed and start operating with an age of above two years.

Potential angel investor is an individual who uses his or her money to provide capital to a private business owned and operated by someone else, who is neither a friend nor family member, and who invests time as well as money in the development of the company if the practice is available.

2.2. Empirical Literature Review

Under this section, previous empirical studies on lack access to finance from traditional sources of finance: commercial banks and MFIs and from the new alternative and innovative sources of finance: angel capital market and related studies in developed and developing countries like Ethiopia will be reviewed.

2.2.1. Traditional sources of finance

In spite of the above theoretical recognition of financing options for MSEs from inception to operation, there appears to be limited empirical evidence available and most of them generally focused on finance as a major challenge of MSEs and suggest solutions from the suppliers' side specially loosening up the sources of finance criteria. As a result, no study had been found that propose alternative source of finance as option which is made in Ethiopia. Slight studies had been done on this regard at developed economies. Related empirical studies are reviewed as follow.

Berger and Udel (2002), paper models the inner workings of relationship lending, the implications for bank organizational structure, and the effect of shocks to the economic environment on the availability of relationship credit to small businesses. The study that was conducted on small business found in United States shows that they depend on both equity (49.63%) and debt (50.37%) as sources of finance. The study empirically evidence suggests that many small business are highly dependent on banks for external finance. One of the technologies that should be employed by banks in extending credit to informationally opaque small businesses is relationship lending. The technology of relationship lending is based on the accumulation of information over time through contact with the firm, its owner, and its local community on a variety of dimensions.

According to the Naoyuki & Farhad (2016), survey conducted by the Asian Development bank on 14 economies from Kazakhstan, the People's republic of china, republic of Korea, Bangladesh, India, Sri Lanka, Cambodia, Indonesia, Malaysia, the Philippines, Thailand and Viet Nam, Papua new Guinea and the Solomon Islands SMEs, to major reasons that slowed the SME growth in Asia. And the study found out that SMEs face lack of finance, to be the major challenge among lack of comprehensive data bases, low level of R&D expenditures and insufficient use of information technology as the major challenge for their growth that inhibit them to grow. The study further propose credit guarantee schemes by government, private SME lenders and hometown investment trust funds for financing risky SMEs and start-ups business as a solution for mitigating the lack of finance challenge. According to Sveinung et al., (2010) access to finance is the major constraints for 25 percent South Asia MSEs' while the same number is close to 48 percent for MSEs found in Sub-Saharan Africa.

According to Mariam (2008), lack of access to finance challenge becomes more critical factor for MSEs for their creation, growth and expansion compared from those who have experience in Tanzania. The study tried to explore the nature and the characteristics of SMEs found in Tanzania together with the financial constraints facing those SMEs. When SMEs were at startup phase personal saving serve as their source of finance for 63.3%, followed by loans and gifts from family (23.3%), profit from business (16.7%) and only 6.7% of SMEs used commercial bank as source of finance the study concluded that most SMEs lack access to finance to start, operate and expand their business. She concluded that.

Daniel et. al., (2011) study which was undertaken in Ghana aiming to develop insight into the decision-making process which lenders employ in granting loans to SME borrowers. The findings from the study backed the researchers to concluded that when loan managers are deciding on whether to accept or reject an SME loan application, among the twenty criteria used in assessing small business borrowers intended purpose of loan, repayment of previous loan, repayment schedule, type of business activity, size of loan relative to size of business and availability of collateral, ranked highest on their criteria list. On the contrary, CVs of clients, government guarantee of loans, charges on assets and gearing ranked lowest on the criteria list in terms of importance.

Hezro & Hilario (2016) argued that there is a relationship between awareness of funding, collateral requirements, small business support and access to finance. The study that was conducted in Maputo central business district of Mozambique on 242 MSEs and 324 staff of Banks helped them to conclude that that there is relationship between awareness of fund and access to finance, collateral requirements and access to finance and small business support and access to finance.

Dereje (2012) stated that financial institutions, banks and microfinance institutions are contributing to SMEs growth. The research examines the role of financial institutions, banks and microfinance institutions in the growth of small and medium enterprises (SMEs). The study was conducted on 120 SMEs found in Addis Ababa. However, the finding shows that the extents of contribution were very low due to high collateral requirements and interest rate. The study recommends a serious of measures which should be performed by the government and by financial institutions. Among the suggested ones' creation of a level playing field, lowering transactional costs and commercial banks should reappraise their role are the first three.

Shortage of finance to expand their business was their principal challenge for 42% and 25.6% for MSEs from 13 regional cities and Addis Ababa respectively caused by lack of collateral and skill on preparation of business plan (FeMSEDA, 2013). To mitigate this problem the study suggested the strengthening of credit provision and giving support on business plan preparation together with record keeping.

Birhanu et al., (2014) study analyzed 3000 sample MSEs to identify success factors, in Addis Ababa and major regional towns in Ethiopia. Sampled MSEs were asked to identify the major business constraints hampering their business. Access to finance tops due to lack of collateral for 73% MSEs among the other major identified constraints. Marketing challenges, working and sales space constraints, capital goods and machinery challenges, licensing and registration challenges, attitudinal challenges and institutional coordination problem follows orderly on the same study. The study concluded that the key success lack of access to finance is one of the key constraints that hamper the business growth. Policy to address this and other identified constrains were proposed by the study.

Vijay & Gebresselassie (2015) investigate MSEs in Tigray Regional zone cities to identify the critical factors that can help MSEs to be sustainable and achieve positive growth so as to limit business failure rate. Out of the survey it was evidenced that entrepreneurial characteristics which include the behavioral aspects of entrepreneur to be one of the critical success factors among firm characteristics and contextual factors for MSEs to be sustainable and achieve positive growth so as to limit the high business failure rate in Ethiopia. The study concludes by suggesting assistance to MSEs with regard to finance, training & development, marketing management, production, logistics & distribution and technology aspects.

Firewoini (2016) argued the most serious constraint facing SMEs found in Ethiopia is lack of access to financing on reasonable terms and condition. The focus of the study were to assess and evaluate access to finance that private enterprises in Ethiopia are having and the factors that hinder them not to properly raise fund. The study was conducted on 150 small, medium and large sized private enterprises located in Addis Ababa. The study showed that the requirement of collateral level being very high obstacles for more than 93% of small and 88% of medium enterprises. This implied more than the medium firms the small firms faced high burden in terms of the required collateral imposed by banks. The findings of the research were lack of access to financing on reasonable terms and conditions was the most serious constraining that SMEs are facing. And the study propose the promoting of policy measures to softening collateral requirements and innovation in financial products for the short run and development of financial market and instruments for the long run were recommended.

2.2.2. Alternative sources of finance

The study that was conducted by Richard (2009) on 72 active angel investors examines what a group of angel investors in South California consider when reviewing an investment opportunity, and how they prioritize their investment criteria. The study utilizes a two-phase approach consisting of a qualitative approach at the first phase and a quantitative in the second phase. The results of this study show that trustworthiness of the entrepreneur, quality of the management team, enthusiasm of the lead entrepreneur, and exit opportunities for the angel are the angles' top criteria.

2.3. Conclusion and Literature Gap

The review of empirical evidence reveals that most of the studies used database survey as their principal sources of data which led to low representativeness.

Berger & Udel (2002) study reveals that SMEs found in United States access finance equally from debt and equity. However, to improve SMEs exposure more on to commercial banks the study commercial banks to employ relationship lending. The study that was conducted on SMEs found in Asia however present that lack of finance is a predominant constraint and the study propose credit guarantee scheme by government, private SME lenders and home town investment trust funds (Naoyuki & Farhad, 2016).

Mariam's study evidenced that finance is a critical factor for MSEs found in Tanzania for their creation, growth and expansion (Mariam, 2008). The study also proves that MSEs use their personal savings as source of finance primarily, then family and friends loan, followed from the profit from business and the last source of finance that is used is from commercial banks. In Ghana availability of collateral ranked the highest in the list of criteria that bank managers while assessing MSEs loan application (Daniel et al., 2011). The study conducted in Mozambique reveals that access to finance to MSEs is affected by the awareness of fund, collateral requirements and business support that they receive (Herzp & Hilario, 2016).

Gebrehiwot & Wolday (2004); While Ageba & Amha (2006) study point out the order of sources of finance that MSEs use to access finance from the existing and traditional sources of finance. Dereje (2012) focuses to show the role that financial institutions play in the growth of MSEs while, FeMSEDA, (2013) studies state the merely existence of lack of finance for MSEs from banks and micro finance institutions, among other problems. Meanwhile Berihun et al., (2014) puts causes to lack of access to finance is lack of collateral for Ethiopian MSEs development while Vijay & Gebresselassie (2015) were engaged on the finding that behavioral aspect of the entrepreneur to be critical factor of success. Finally, Firewoini (2016) declared that collateral request obstacles SMEs to access finance again from debt financing option. All these studies remark the existence of lack of access to finance due to different reasons while they suggest somehow similar solution which is to make the existing and traditional source of finance to be accessed due to different intervention rather than opting for alternative and new innovative source of financing option for MSEs found in Ethiopia.

On the other hand, in Ethiopia there has been relatively none evidence on the financing option of angel investment however, the study that was conducted in South California exhibited that angel investors review an investment opportunity with criteria of trustworthiness of the entrepreneur, quality of the management team, enthusiasm of the lead entrepreneur, and exit opportunities were ranked from top.

In conclusion, the literature review has showed that, although empirical evidence appears to be limited, there is alternative and new innovative source of financing option. However, there is high focus of alternative and new innovative source of financing option in developed countries. On the other hand, in developing countries there have been a relatively limited number of studies on alternative and new innovative source of financing option.

Finally, to the knowledge of the researcher, in Ethiopian context there appear that no attempts have been made to examine the alternative and new innovative source of financing option for MSEs from inception to operation. This gap in the literature led to the current research objectives:

- *To describe the previously accessed sources of finance by MSEs,*
- *To examine the extent how MSEs fulfil collateral, capacity, capital, condition, character, documentation, proposal and interest rate requirements that commercial banks put upfront for accessing finance in Ethiopia,*
- *To examine the extent how MSEs fulfil the collateral, capacity, capital, condition, character, documentation, proposal and interest rate requirements that micro financial institutions put upfront for accessing finance in Ethiopia,*
- *To examine the extent how MSEs fulfil the trustworthiness, collateral, management team, perceived financial reward and potential exit routes (liquidity) requirements that potential angel investors put upfront for accessing finance in Ethiopia,*

This study is needed for three reasons. Firstly, there is no reliable and comprehensive study that examines the alternative and new innovative source of financing option for MSEs from inception to operation in Ethiopia. Secondly, it will pave the way forward for policy makers, FeMSEDA, ReMSEDA, financial institutions, MSEs and stakeholders to understand the alternative and new innovative source of financing option for MSEs from inception to operation. Finally, this study advances the knowledge of the alternative and new innovative source of financing option for MSEs from inception to operation in Ethiopia.

Chapter Three

3. Research Methodology

The way in which research is conducted may be conceived of in terms of the research philosophy subscribed to, the research approach employed and the research instruments developed and utilized in the pursuit of a goal- the research objective(s)- and the search for the solution of a problem – the research question.

The purpose of this chapter is to present the research methodology adopted in this study. This chapter is arranged as follows. Section 3.1 presents the research design and approach that is employed for the study. Section 3.2 is devoted to the sample size and sampling techniques while section 3.3 to data collection techniques, section 3.4 to pre-testing, section 3.5 to validity and reliability, section 3.6 to data analysis and finally section 3.7 to limitation.

3.1. Research Design and Research Approach

Quantitative, qualitative, and mixed methods are the three common approaches to conducting research. Researchers typically select the quantitative approach to respond to research questions requiring numerical data, the qualitative approach for research questions requiring textural data, and the mixed methods approach for research questions requiring both numerical and textural data (Carrie, 2007). The advantage of quantitative which is well designed and implemented is its ability to make generalizations to a wider population from the sample through standardizes procedures. Out of the standardization reliability of the findings is enhanced. While the limitations are Lack flexibility, hinder exploitation of new ideas (Creswell, 2003).

In the same manner qualitative approach has its own advantage and limitations. One of the advantage of qualitative approach as per Cresswell (2003) is its flexible and its ability to increase a research's depth of understanding (Wimmer & Joseph, 2006) while the limitations are lack of standardized rules reduces the objectivity of the findings, the personal view and stand of the researcher may induce bias in the interpretation of the data, and the findings cannot be statistically generalized for a broader population under investigation (Creswell, 2003).

As indicated in the above discussion, both qualitative and quantitative research approaches have limitations. The advantage of a quantitative research approach may be limitation for a qualitative approach and vice versa (Creswell, 2003). Mixed research design, which is supposed to alleviate the limitations of quantitative and qualitative approaches, is being used by many researchers to understand the problem which is the most important (Creswell, 2003).

In the light of the research problem and the underlying philosophy of each research approach highlighted above, the current research combines both qualitative and quantitative research approaches. That is to get the benefits of mixed method approach.

The nature of the research that was selected is descriptive. Since, the research is to examine the alternative and new innovative source of financing option, angel capital market, can be another source of finance for idea level, Start-ups and existing MSEs in Ethiopia. Among from the available approaches the deductive approach was used for the research since the study is engaged on proving the new alternative and innovative source of finance would be preferred to be accessed by MSEs than the available existing and traditional source of finance.

The study adopted mixed design to demonstrate the practice of accessing finance from the new alternative and innovative source of finance is more accessible than the existing and traditional sources to MSEs. Specifically, the study uses survey of MSEs and potential angel investors, and in-depth interviews with banks and MFI managers/officials. Mixed research design, which supposed to alleviate the limitations of quantitative and qualitative approaches, used instead of methods being important, to understand the case at hand as it was put in 2003, Creswell's study.

The quantitative aspect of the research method intends to obtain data needed to generalize the new alternative and innovative source of finance: angel capital market is more accessible than the existing and traditional sources of finance: commercial banks and MFIs to MSEs from inception to operation in Ethiopia from MSEs and potential angel investors. To substantiate the data obtained through survey and to get clarification on some issues in-depth interviews with bank managers and MFIs loan officers was also used.

3.2. Target Population

The population of Micro and small enterprises found in Ethiopia is not only too large and their distributions across regions have been diverse but also neither the records showing their lists were available. Primarily the researcher took one administrative region (Addis Ababa) and five (Amhara, Eastern (Harare and Somalia), Oromiya, SNNPR and Tigray) regions that can represent Ethiopia. Within these regions all types of business activities and sectors found in the country is believed to be demonstrated. Further stratification was done with criteria that attended Entrepreneurial Training Workshop (ETW) and successfully attended the Business Development Service (BDS) that is provided by FeMSEDA in collaboration with UNDP through Entrepreneurship Development Center Ethiopia (EDC) which is free for all Ethiopians who are at idea, start up or existing level.

The populations of this study are MSEs found at all level in Ethiopia and to support the analysis state owned and private commercial banks, microfinance institutions and potential angle investors, are included too. All commercial banks are 17 and microfinance institutions are 35.

The population size of potential angle investors is made up of individual investors who do not make up a known population as Scote (2008) also mentioned on his paper.

3.3. Sample size and sampling techniques

The purpose of survey research is to generalize from a sample to a population so that description can be made about some characteristic, attitude, or behavior of this population (Babbie, 1990). For this study, survey method is preferred considering the advantage that is embedded in this method regarding to the low cost and the rapid turnaround of the data collection. The populations of this study are MSEs found at all levels in Ethiopia and to support the analysis state owned and private commercial banks, microfinance institutions and potential angle investors, were included too.

Within the regions further stratification was done with criteria that attended Entrepreneurial Training Workshop (ETW) and successfully attended the Business Development Service (BDS) that is provided by FeMSEDA in collaboration with UNDP through Entrepreneurship

Development Center Ethiopia (EDC) which is free for all Ethiopians who are at idea, start up or existing level. Following that the researcher went to major regions of the country and systematically (based on the criteria of attended ETW and successfully completed BDS) selected for the survey. The stratified population number of MSEs at all level is 2219 (EDC, 2016). Out of this total population with the estimation of non-respondence of 19%, confidence level 95% and 5% marginal error the sample size became 384.

Table 3.1: Minimum Sample Size Proposed for Selected Regions

MSEs level	Size of MSE							Proportion (%)	Minimum sample size required
	Addis Ababa	Amhara	Eastern(Harar &Somalia)	Oromia	SNNPR	Tigray	Total		
Idea level	38	88	0	0	57	0	183	8	33
start-up	320	52	3	2	44	69	490	22	84
Existing	374	539	94	172	178	189	1546	70	267
Total	732	679	97	174	279	258	**2219**	**100**	**384**

The researcher used proportionate stratified random sampling and have equal selection from idea, start-up and existing level MSEs, so that the result become relevant.

The minimum sample size is achieved based on Godden (2004) simplified formula for calculating sample size of a population that is less than 10,000 is given.

$$SS = \frac{Z^2 \times (p) \times (1-p)}{C^2}$$

SS = Sample Size

Z = Z-value* (in this case 1.96 for a 95% confidence level)

P = Percentage of population picking a choice (in this case 0.5)

C = Confidence interval, expressed as decimal (in this case +/- 5% points)

$$SS = \frac{3.8416 \times 0.5 \times 0.5}{0.0025}$$

$$SS = 384$$

The above one is for sample size for infinite population, the reason it is computed is to derive sample size from that to calculate the sample size for a finite population.

$$New\ SS = \frac{SS}{1 + (\frac{SS-1}{Pop}))}$$

Pop = 2219

$$New\ SS = \frac{384}{1 + (\frac{384-1}{2219}))}$$

$$New\ SS = 323$$

The sampling techniques selected for financial institutions is purposive sampling particularly criterion sampling in which the financial institutions' service years, the oldest and the youngest were taken as a criterion. Commercial banks and micro financial institutions that meet the criteria were selected as a sample. From commercial banks Ethiopian Commercial and Abay banks were selected and from micro finance institutions Meklit and Addis Micro were chosen.

For potential angel investors, to overcome the prone to biases and inaccuracies of convenience samples the researcher took as large as possible representative samples which is appropriate and the technique that was engaged was non-probability sampling specifically convenience sampling techniques to reduce non-response rate (Morse, 1998). Since it is not possible to calculate the probability of each potential angle investor being involved in the research sample selecting the non-probability sampling justified it. It is often hard to determine the angel investors' population size however to make the result generalizable, the research took as twice as of the sum of the total population of commercial banks (19) and microfinance financial institutions (35). So, the sample size of the angle investors is 108.

3.4. Data Collection techniques

The procedure for sampling the MSEs, commercial banks and micro finance institutions is proportionate stratified random sampling while for potential angel investors it is nonrandom specifically convenient sampling. For MSE's questionnaires were used which was developed by World bank group, again for potential angle investors questionnaires were used which was developed by Osnabrugge & Robinson (2000) and both sets of questionnaires were customized to parallel the context that is found in Ethiopia, and finally for commercial banks and micro finance institutions structured in-depth interview were used which was developed by World bank group. Both categorical and continuous measures of scales were addressed in all groups of survey. Before taking the full-size survey for each group, pilot questionnaires were distributed for 10 MSEs, 10 potential angle investors, 2 commercial banks and 2 micro finance institutions. And from the response and feedback some contents were customized in all groups of instruments. The time line for administering the survey for MSEs before distributing the questionnaires phone calls were made a week ahead to ask their willingness and to fix appointment, and after getting their willingness Schedule was confirmed; questionnaires were distributed and were reached to an agreement that after two weeks the filled-out questionnaires were collected. And after two weeks a gentle reminder was done through phone call, with this call another appointment were fixed for physical appearance to collect the questionnaires for those who were and were not done by the time of phone call. For commercial banks and micro finance institutions first phone call was made to ask the person who answered the phone (mostly the secretary) to schedule appointment with the credit manager of the institutions. After getting the schedule first meeting with the credit managers were conducted and brief discussion about the purpose of study and inquiry of the next convenient schedule for the interview were sat. And according to the fixed schedules interviews were conducted. For the group of Potential angel investors to collect data questionnaires were emailed through internet. A week before sending the questionnaires an email message was sent that was asking if they are willing to participate in the study with the description of the purpose of the study. For those who replied their willingness the set of questioners was sent. After two weeks an email to gently remind them to send back the filled-out questionnaires were sent and after a week a thank you email was sent to those who did send back the filled-out questionnaires as per the schedule. The rationales for using email for collecting data are its strength regarding cost and time effectiveness to access as many as possible potential angle investors who are found throughout the world. Since most of the potential angle investors for this specific study are found abroad using email to communicate with them was convenience for them. The rationale for the procedure of collecting data through internet is by the strengths on lowering cost, decrease the time spent traveling and the availability of connection and convenience (Nesbary, 2000). The researcher used in-depth interview and questionnaires to collect primary data.

The researcher used questionnaires for MSEs and potential angle investors while in-depth interview to collect primary data from commercial banks and microfinance institutions.

3.5. Pre-testing

Before the real study, the researcher conducted trial on MSEs, commercial banks, MFIs and potential angel investors which weren't included in the real study. Pre-testing of the instruments were carried out on 10 MSEs, **2** commercial banks, **2** MFIs and **10** potential angel investors randomly sampled outside those sampled for the study. Pre-testing was done to enhance consistency and dependency, accuracy and adequacy of the instruments. Consistencies of the test items were measured by the degree to which the test items attracted similar and related responses from the samples in the pilot testing exercise.

3.6. Validity and Reliability

3.6.1. Validity

Validity refers to the degree to which the measures of the instruments measure what it is supposed to measure (Joppe 2000; Mugenda, 2008). Content validity was determined by pre-testing. This determined whether the items were correctly worded to avoid misinterpretation when they are finally administered to the samples in the main study. After pre-testing the instruments were adjusted.

3.6.2. Reliability

Reliability of research instruments indicates the degree to which the research is without bias therefore ensured consistent measurement across time and the several items within instrument (Kothari, 2004). The reliability was measured to find out the degree to which the measuring items gave similar results over many repeated trials. A test-retest reliability method was used to estimate the degree to which the same results could be obtained with a repeated measure of accuracy of the same concept to determine the reliability of the instrument.

3.7. Data Analysis Methods

Descriptive statics have been used to analyze the data obtained from MSEs and potential angel investors. The analysis of the data was conducted with the use of SPSS software. The descriptive statistics analyze the refined data involving percentages and frequency. Frequency distribution, tables and pie-charts were used to organize and give a summary of the data and display in a meaningful and understandable manner to assist in describing and interpreting the outcome of the research.

To substantiate the data obtained through survey analysis and to get explanation on some issues, in-depth interviews with banks and MFIs managers/officials was also used. This form of data collection procedures constitutes the qualitative aspect of the study.

Chapter Four

4. Data Presentation, Analysis and Discussion of Results

This chapter will present and analyze the data collected and discussion accordingly. Out of the total questionnaires distributed for Micro and small business owners 389, 88.9% were properly filled and returned. While 107 questionnaires were disseminated for potential angel investors and 68.2% were collected back safely. Summary of the number of questionnaires distributed and collected is put on table 4.1.

4.1. Characteristics of MSEs

Table 4.1. Summary of Questionnaire Distribution and Collection Rate

No	Group of respondents	Questionnaire distributed	Questionnaire collected	Percentage of collection
1	Micro and Small Enterprises (Total)	389	346	88.9%
2	Potential angel investors	108	73	68.2%

Source: Research questionnaire

As indicated in the above table from the total of 389 MSEs, found at idea level, starting up and existing, for whom questionnaire was distributed 346 (88.9%) respondents' responses are collected and the remaining 43 (11.1%) are not collected due to different reasons. On the next Table 4.2 and 4.23 the business profile is shown.

Table 4.2: Age of business

Description	frequency	Percentage (%)
Age of the business		
• Idea level	30	8.7%
• Business with an age of up to 2 years	250	72.3%
• Businesses with an age of above 2 years	66	19.1%
Total	**346**	**100%**

Source: Research questionnaire

30 or 8.7% are businesses found at idea level, 250 or 72.3% are businesses with an age of up to two years and 66 or 19.1% are businesses with an age of above two years. From this, we can infer that most of the respondents start to operate in the economy and have a relative business experience.

Table 4.3Business by number of employees

Description	frequency	Percentage (%)
No of employees		
• 1 - 5	225	71.2%
• 6 - 10	91	28.8%
Total	**316**	**100%**

Source: Research questionnaire

225 or 71.2% MSEs have employee number between 1 and 5 and 91 or 28.8% MSEs have employee number between 6 and 10. From the above data, there is no doubt that all respondents are MSEs as supported by the definition contained in Regulation No 201/2011 by Federal Micro and Small Enterprise Development Agency (FeMSEDA).

4.2. MSEs' trend of efforts of accessing finance: Demand side

To understand and propose appropriate source of finance for MSEs found at different level, it is wise to consider their trend of efforts of accessing finance from different sources. Figuring out the trend asks to get the clear picture of the previously accessed, currently processing activities and aspiring sources of finance by MSEs from their experience on the practice of accessing sources of Finance. Sources of finances used before 6 months displayed the history while accessed within the last six months portrait the current and at last part that will complete the trend was the source of finance that the MSEs are planning and able to access finance.

4.2.1 Previously accessed sources of finance

The need for finance for any business from inception to operation level is a known fact all over the world and this is not different from the responses received from the target respondents. MSEs found at idea, starting up and existing level who took part in this study were however asked from which source of finance they have raised finance before 6 months. Among all other sources of finance ranging from personal saving and partners' contribution, loan from family and friends, microfinance institutions, commercial banks and Iqub the participants MSEs used own savings and partners contribution as the primary source of finance. Internal sources of finance which are own savings and partners contributions were used by all respondents and commercial banks loan was not requested at all as it is recorded 100% before 6 months. The participants answer is displayed as follow.

Table 4.4 Previously Accessed Sources of Finance

Sources of finance	Requested & granted		Requested & not granted		Did not request.	
	Frequency	Percent %	Frequency	Percent %	Frequency	Percent %
Commercial Bank loan	0	0%	0	0%	346	100%
Microfinance Institutions	42	10.4%	287	82.9%	23	6.6%
Personal savings and Partners' contributions	346	100%	0	0%	0	0%
Loan from family and friends	228	65.9%	52	15.0%	66	19.1%
Iqub	119	37.7%	131	37.9%	66	19.1%

Source: Research questionnaire

The above table shows none of the MSEs granted finance since they didn't request from Commercial bank loan. 42(10.54) MSEs requested finance and granted the amount they requested and 287 (82.9%) requested and not granted while 23 (6.6%) MSEs did not request from Microfinance institutions. 346 (100%) MSEs requested finance and granted the amount they requested and 0 (0%) requested and not granted while 0 (0%) MSEs did not request from Personal savings and Partners' contributions. 228 or 65.9% of MSEs requested finance and granted from their families and friends while 52, 15.0% requested and were not granted and the rest 66 or 19.1% did not have families and friends who have the capacity to provide them loan. 119 or 37.7%, MSEs requested finance and granted the amount they requested and 131 or 37.9% requested and not granted while 66 or 19.1% MSEs did not request from Iqub. This implies sampled MSEs didn't use commercial banks and microfinance institutions as source of finance while personal and partners' savings and loan from family and friends were used as source to access finance for business.

Table 4.5 Accessed finance amount

Sources of finance	Yes, I have received fully		Yes, I have received partly	
	Frequency	Percent (%)	Frequency	Percent (%)
Micro finance Institution	17	40.5%	25	59.5%
Personal savings and Partners' contributions	22	6.4%	324	93.6%
Families and friends	117	40.6%	111	59.4%
Iqub	20	16.8%	99	83.2%

Source: Research questionnaire

On table 4.5 Among those who have applied from microfinance institution 17 or 40.5% have received fully and 25 or 59.5% have received partly from the amount of finance that they have applied, from 346 whom applied from personal saving and partners' contribution 22 or 6.4% have received fully while 324 or 93.6% have received partly, from 228 whom applied loan from families and friends 117 or 40.6% have received fully the amount of finance that they applied while 111 or 59.4% received partly and 20 or 16.8% have received from fully and 99 or 83.2% of the respondents received partly the amount of finance from Iqub. This clearly shows commercial bank is failed to be used as sources of finance completely while it is only 4.9% of the sampled respondents used micro financial institutions as source of finance, while the equity financing option is used better than the debt financing option still the existing of financial gap from their previous sources of finance is clearly visible.

4.2.2. Current sources of finance

Participants were asked which source of finance they are accessing **currently** by posing question saying from which source of finance they have applied within the last 6 months, and the participants respond is summarized as in the following table4.6.

Table 4.6 Current Source of Finance

Sources of finance	Yes, I have accessed		No, I haven't accessed	
	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	0	0.0%	346	100.0%
Micro finance Institution	33	9.5%	313	90.5%
Personal savings and Partners' contributions	118	34.1%	228	66.1%
Loan from family and friends	45	13.0%	301	87.0%
Iqub	149	43.0%	197	57.0%

Source: Research questionnaire

From the table 4.6, 0 or 0% have accessed and 346 or 100% have not accessed to commercial banks, 33 or 9.5% have accessed and 313 or 90.5% have not applied from micro finance institutions, 118 or 34.1% have accessed, 288 or 66.1% have not accessed from families and friends and 45 or 13% have accessed and 301 or 87.0% have not accessed from the business profit and 149 or 43% have accessed and 197 or 57% have not accessed from Iqub used as source to access finance. Debt financing option is not currently used by the respondents. Commercial banks took the lead by shutting down its door totally for the businesses while Micro financial institutions are following by not being used as a source of finance. Equity financing option is on better position to be used as current source of finance by the businesses while personal savings and members contribution takes the lead and followed by Iqub and loan from family and friends. Still large proportion of the sampled SMEs is not financing their current businesses due to the current and traditional sources of finance are not being used as source of finance.

The respondents were also asked whether they have received fully or partially the amount of finance that they requested from their current sources of finance.

Table 4.7 Accessed Current Source of Finance

Sources of finance	Yes, I have received fully		Yes, I have received partly	
	Frequency	Percent (%)	Frequency	Percent (%)
Micro finance Institution	0	0.0%	33	100.0%
Personal savings and Partners' contributions	14	11.9%	104	88.1%
Loan from family and friends	3	6.7%	42	93.3%
Iqub	26	17.4%	123	82.6%

Source: Research questionnaire

On the above table, 33 or 100% whom applied from micro finance institution 0 or 0% have received fully and 33 or 100% have received partly from the amount of finance that they have applied, from 118 or 100% whom applied from personal savings and partners contributions 14 or 11.9% have received fully the amount of finance that they applied for while 104 or 88.1% received partly, from 45 or 100% whom applied from family and friends 3 or 6.7% have received fully while 42 or 93.3% have received partly, and 149 or 100% whom applied from Iqub 26 or 17.4% have received fully and 123 or 82.6% have received partly the amount of finance that they have requested. The fact that is displayed from the sampled MSEs the majority didn't receive the amount of finance they request from any of the listed sources. Among the list of sources of finance micro finance institutions and families and friends are categorized as formal external and informal external sources of finance consequently. Again, this shows the existing of financial gap from the current sources of finance by sampled SMEs which calls for new, innovative and alternative source of finance.

4.2.3. Future usage of sources of finance

To see in detail the future plan of MSEs' source of finance the researcher put questions for those who have experience on accessing finance from different sources into three parts. The first part asks about growth expectations of MSE's, while the second asks about required amount of finance and the third part about obstacle factors to access finance from different sources.

4.2.3.1. Growth expectations of MSEs'

MSEs, respondents, were asked how much they would expect their business to grow over the next two to three years in terms of turnover; their answers are displayed on the next table.

Table 4.8: Growth expectations of MSE's

No	Growth expectations	MSEs	
		Frequency	Percent (%)
1	Grow substantially	308	89%
2	Grow moderately	38	11%
3	Stay the same size	0	0%
4	Become smaller	0	0.0%
Total		346	100%

Source: Research questionnaire

On the above table 308 or 89% of the respondents showed that they expect substantial growth while 38 or 11% moderate growth, 0 or 0% stay the same size and 0 or 0% expect to become smaller. This shows the need for resource to make their expectation into the reality is essential.

4.2.3.2. Required amount of finance

Respondents were asked the amount of finance that they would aim to obtain to realize their businesses growth expectations. The major respondents, 59%, aim to obtain an amount of between 20, 0001 and 50,000 Birr. This and the rest respondents answer is summarized on table 4.9.

Table 4.9: Required amount of finance

No	Description	Frequency	Percent (%)
1	Less than 5, 000 Birr	0	0%
2	5,000 – 10,000 Birr	4	1.1%
3	10,001 – 20,000 Birr	19	5.5%
4	20,001 – 50,000 Birr	204	59%
5	50,001 - 100,000 Birr	95	27.5%
6	Over 100,000 Birr	24	6.9%
Total		346	100.0%

Source: Research questionnaire

Among 346 respondents 0 or 0% are aiming to obtain for less than 5,000 Birr, 4 or 1.1% for between 5,000 and 10,000 Birr, 19 or 5.5% for between 10,001 and 20,000 Birr, 204 or 59% for between 20,001 and 50,000 Birr, 95 or 27.5% for between 50,001 and 100,000 Birr and 24 or 6.9% are aiming to obtain over 100,000 Birr. From the above data it is clear that the majority of the respondents do require for an amount of money that lies between 20,001 up to 50,000. If the amount of finance that most sampled MSEs are requesting is less than 100,000, then what will be the obstacle factor that unable the MSE to use the existing and traditional sources of finance will be answered on the next sub section.

4.3. Obstacle factors to access finance from different sources

To describe the factors that contribute for future usage of finance source the researcher asked the sampled MSEs those who have experience accessing finance from commercial banks and microfinance institutions to prioritize factors among collateral, capacity, capital, condition, and managerial expertise's, documentations, project proposal, previous credit record and interest rate that will be obstacle to access finance from existing sources of finances which are Commercial banks and Micro financial institutions. Sources of debt financing, commercial banks and micro financial institutions are the sources that most MSEs use traditionally. Yet the new, innovative and alternative source of finance, Angel investment, under equity financing option is not explored to see whether it can narrow down the wide existing financial gap. To minimize as much as possible this financial gap sampled MSEs were asked to prioritize the same factors that are put under the debt financing option plus control over the business, financing option availability and potential exit routes (liquidity) were examined as factors that have been obstacle to assess finance from the new and innovative source of finance which is Angel investment. Factors that were considered to be obstacles for MSEs were criteria by different sources of finance. The respondents' answers are summarized as on the following table.

Among the factors that were put to be prioritized as obstacle to access finance from commercial banks, micro finance institutions and Angel investment by sampled SMEs lack of collateral become the extremely significant factor from commercial banks and micro finance institutions while it is not significant factor from Angel investments at 100%. The detail answers from the participants are displayed on tables (4.10-4.20)

Table 4.10: Lack Collateral

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	0	0%	0	0%	0	0%	329	100%
Micro finance	0	0%	0	0%	36	10.9%	293	89.1%
Angel investors	329	100%	0	0%	0	0%	0	0%

Source: Research questionnaire

Collateral, lack of collateral is prioritized as not significant for 0 or 0%, is marginally significant for 0 or 0% is very significant for 0 or 0%, and extremely significant factor, for 329 or 100% of those who have experience in accessing finance from commercial banks previously become extremely significant obstacle factor to access finance from commercial banks. This factor is prioritized as not significant for 0 or 0%, is marginally significant for 0 or 0% is very significant for 36 or 10.9%, and extremely significant factor for 346 or 100% sampled SMEs to access finance from micro finance institution. However, Lack of collateral is prioritized as not significant for 329 or 100%, is marginally significant for 0 or 0%, and is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from Angel investment. This means 329 or 100% sampled MSEs prioritized lack of collateral as extremely significant factor to access finance from commercial banks and micro financial institutions which are found under debt financing option, while lack of collateral is not a significant factor to obstacle all SMEs that are under the study to access finance from Angel investment which is found under equity financing option. This shows clearly that access to finance from commercial banks and micro financial institutions due to the requirement of collateral is obstacle as a factor to access finance while this factor will not be from Angel investment. The inability of the MSEs to provide collateral inhibits them to use the existing and traditional, debt, as a source of finance. However, this factor will not be totally a restricting factor for MSEs found in Ethiopia to use the new, innovative and alternative option, which is found under equity financing, and is called angel investment. This study found that houses and business buildings are used as security and that commercial banks and MFIs demand MSEs to post collateral in order to reduce moral hazard. This finding is in line with the findings Hezron and Hilario (2016) that banks ask for collaterals in order to finance MSEs and to accept loan proposal and that collateral must therefore be 100% or more, equal to the amount of credit extension or finance product.

Table 4.11: Lack of Capacity

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	0	0%	0	0%	0	0%	329	100%
Micro finance	0	0%	105	31.1%	145	44.1%	79	24%
Angel investors	0	0%	45	13.7%	132	40.1%	152	46.2%

Source: Research questionnaire

Capacity, lack of capacity to repay debt is prioritized as not significant for 0 or 0%, is marginally significant for 0 or 0% is very significant for 0 or 0%, and extremely significant factor, for 329 or 100% of those who have experience in accessing finance from commercial banks previously become extremely significant obstacle factor to access finance from commercial banks. This factor is prioritized as not significant for 0 or 0%, is marginally significant for 105 or 31.1%, is very significant for 145 or 44.1%, and extremely significant factor for 79 or 24% sampled SMEs to access finance from micro finance institution. However, Lack of capacity is prioritized as not significant for 0 or 0%, is marginally significant for 45 or 13.7%, and is very significant for 132 or 40.1%, and extremely significant factor for 152 or 46.2% sampled SMEs to access finance from Angel investment. This means that SMEs are required to show their business capacity to repay the debit by the business and failing to show this due to different reasons became extremely significant by all, 24% and 46.2% participants to use commercial banks, micro financial institutions and angle investors consecutively as source of finance.

Table 4.12: Lack of Capital

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	0	0.0%	2	0.6%	275	83.6%	52	15.8%
Micro finance	43	13.1%	111	33.7%	123	37.7%	52	15.8%
Angel investors	190	57.8%	139	42.3%	0	0%	0	0%

Source: Research questionnaire

Capital, inadequate amount of equity invested in the business by the owner is not significant for 0 or 0%, is marginally significant for 2 or 0.6%, is very significant for 275 or 83.6%, and extremely significant factor for 52 or 15.8% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 43 or 13.1%, is marginally significant for 111 or 33.7%, is very significant for 123 or 37.7%, and extremely significant factor for 52 or 15.8% sampled SMEs to access finance from micro finance institution. However inadequate amount of equity invested in business by the owner is prioritized as not significant for 190 or 57.8%, is marginally significant for 139 or 42.2%, and is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from Angel investment. This means the amount of equity invested in the business by the owner which is capital is extremely significant factor for both for commercial banks and micro finance institutions while it is not to access finance from the angel investment.

Table 4.13: Bad Condition

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	60	18.2%	229	69.6%	40	12.2%	0	0%
Micro finance	62	18.8%	210	63.8%	66	20%	0	0%
Angel investors	0	0.0%	147	44.7%	182	55.3%	0	0%

Source: Research questionnaire

Condition, bad conditions of the economy in which the business operates is not significant for 60 or 18.2%, is marginally significant for 229 or 69.6%, is very significant for 40 or 12.2%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 62 or 18.8%, is marginally significant for 210 or 63.8%, and is very significant for 66 or 20%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from micro finance institution. However bad conditions of the economy in which the business operates is prioritized as not significant for 0 or 0%, is marginally significant for 147 or 44.7%, and is very significant for 182 or 55.3%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from Angel investment. This means that the condition of the economy in which the business operates is prioritize as not significant factor most of sampled participants to access finance both from commercial banks and micro financial institution while it is not significant to access finance from Angel investors since they are interested about the future gain rather than the condition.

Table 4.14: Lack of Character

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	0	0.0%	48	14.6%	253	76.9%	28	8.5%
Micro finance	4	1.2%	76	23.2%	228	67.7%	25	7.9%
Angel investors	1	0.3%	184	55.9%	144	43.8%	0	0%

Source: Research questionnaire

Character, work experience, experiences in the industry and personal credit history are all character traits that sources of finance will consider. Lack of character is not significant for 0 or 0%, is marginally significant for 48 or 14.6%, is very significant for 253 or 76.9%, and extremely significant factor for 28 or 8.5% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 4 or 1.2%, is marginally significant for 76 or 23.2%, is very significant for 228 or 67.7%, and extremely significant factor for 25 or 7.9% sampled SMEs to access finance from micro finance institution. However, lack of managerial expertise is prioritized as not significant for 1 or 0.3%, is marginally significant for 184 or 55.9%, and is very significant for 144 or 43.8%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from Angel investment. This means lack of character is very significant obstacle factor for sampled MSEs to access finance from commercial banks and micro finance institution while this factor is marginally significant to access finance from angel investments.

Table 4.15: Poor Documentation

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	69	21.0%	151	45.9%	108	32.8%	1	0.3%
Micro finance	12	3.6%	284	86.3%	33	10%	0	0.0%
Angel investors	0	0.0%	145	44.1%	184	55.9%	0	0%

Source: Research questionnaire

Documentation, poor documentation is not significant for 69 or 21%, is marginally significant for 151 or 45.9%, is very significant for 108 or 32.8%, and extremely significant factor for 1 or 0.3% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 12 or 3.6%, is marginally significant for 284 or 86.3%, is very significant for 33 or 10%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from micro finance institution. However poor documentation is prioritized as not significant for 0 or 0%, is marginally significant for 145 or 44.1%, and is very significant for 184 or 55.9%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from Angel investment. Keeping records of transactions are main documents that business need to document in order to generate financial reports which are the basic criteria for financial institutions to give loans. Since angel investors are interested more on the proposed profit the detail records of any occurred transactions are not as part as of the valuation of businesses.

Table 4.16: Proposal

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	0	0.0%	185	56.2%	144	43.8%	0	0.0%
Micro finance	183	55.6%	0	0%	146	44.4%	0	0.0%
Angel investors	0	0.0%	0	0%	7	2.1%	322	97.9%

Source: Research questionnaire

Proposal, project proposal not accepted, is not significant for 0 or 0%, is marginally significant for 185 or 56.2%, is very significant for 144 or 43.8%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 183 or 55.6%, is marginally significant for 0 or 0%, is very significant for 146 or 44.4%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from micro finance institution. However, project proposal is prioritized as not significant for 0 or 0%, is marginally significant for 0 or 0%, and is very significant for 7 or 2.1%, and extremely significant factor for 322 or 97.9% sampled SMEs to access finance from Angel investment.

This means that both sources of finance which are commercial banks and micro financial institutions require project proposal from MSEs and the majority of the sampled MSEs prioritized this factor as very significant while extremely significant to access finance from Angle investments.

Table 4.17: Previous Record

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	0	0.0%	0	0.0%	0	0.0%	329	100%
Micro finance	0	0.0%	0	0.0%	0	0.0%	329	100%
Angel investors	329	100.0%	0	0.0%	0	0.0%	0	0.0%

Source: Research questionnaire

Record, Previous bad credit record is not significant for 0 or 0%, is marginally significant for 0 or 0%, is very significant for 0 or 0%, and extremely significant factor for 329 or 100% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 0 or 0%, is marginally significant for 0 or 0%, is very significant for 0 or 0%, and extremely significant factor for 329 or 100% sampled SMEs to access finance from micro finance institution. However previous credit record is prioritized as not significant for 329 or 100%, is marginally significant for 0 or 0%, and is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from Angel investment. A bad record on paying back loan is a good reason to reject the next loan request by commercial banks and micro financial institutions.

Table 4.18: Interest rate

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	4	1.2%	95	28.9%	8	2.4%	222	67.5%
Micro finance	0	0.0%	0	0.0%	0	0.0%	329	100%
Angel investors	329	100.0%	0	0.0%	0	0.0%	0	0.0%

Source: Research questionnaire

Interest rate, high interest rate is not significant for 4 or 1.2%, is marginally significant for 95 or 28.9%, is very significant for 8 or 2.4%, and extremely significant factor for 222 or 67.5% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 0 or 0%, is marginally significant for 0 or 0%, is very significant for 0 or 0%, and extremely significant factor for 329 or 100% sampled SMEs to access finance from micro finance institution. However high interest rate is prioritized as not significant for 329 or 100%, is marginally significant for 0 or 0%, and is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from Angel investment. This means that MSEs find high interest rate as an obstacle factor to access finance from commercial banks and micro finance institutions. Interest rate is not significant obstacle factor at all.

Table 4.19: Ownership

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	329	100.0%	0	0.0%	0	0.0%	0	0.0%
Micro finance	329	100.0%	0	0.0%	0	0.0%	0	0.0%
Angel investors	0	0.0%	29	8.8%	230	69.9%	70	21.3%

Source: Research questionnaire

Ownership, reduction of control over the business, not significant for 329 or 100%, is marginally significant for 0 or 0%, is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 329 or 1000%, is marginally significant for 0 or 0%, is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from micro finance institution. However, reduction of control over the business is prioritized as not significant for 0 or 0%, is marginally significant for 29 or 8.8%, and is very significant for 230 or 69.9%, and extremely significant factor for 70 or 21.3% sampled SMEs to access finance from Angel investment. This means sharing ownership is not significant obstacle factor to use commercial banks and micro financial institutions as source of finance while it is very significant for the majority of respondents to use angel investment.

Table 4.20: Availability

Sources of finance	Not significant		Marginally significant		Very significant		Extremely significant	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Commercial banks	329	100.0 %	0	0.0%	0	0.0%	0	0.0%
Micro finance	329	100.0 %	0	0.0%	0	0.0%	0	0.0%
Angel investors	0	0.0%	0	0.0%	0	0.0%	329	100.0 %

Source: Research questionnaire

Availability, financing option being not available or practiced, not significant for 329 or 100%, is marginally significant for 0 or 0%, is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from commercial banks. This factor is prioritized as not significant for 329 or 100%, is marginally significant for 0 or 0%, is very significant for 0 or 0%, and extremely significant factor for 0 or 0% sampled SMEs to access finance from micro finance institution. However, financing option being not available or practiced is prioritized as not significant for 0 or 0%, is marginally significant for 0 or 0%, and is very significant for 0 or 0%, and extremely significant factor for 329 or 100% sampled SMEs to access finance from Angel investment. This means MSEs have no problem of the availability of source of finance from commercial banks and micro finance institution. Angel investment as alternative source of finance is not practiced at all which brings the availability of the practice as extremely significant obstacle factor.

4.4. Criteria of different sources of finance: Supply side

To analyze appropriate source of finance for MSE's found in Ethiopia, evaluation of "criteria of different sources of finance" is the central part of the process; it is also equally important that evaluating the criteria or precondition that the sources of finance require the MSE's in order to analyze the appropriateness and availability of source of finance. Results concerning the criteria that commercial banks and micro financial institutions were obtained through interview with credit officers and loan managers respectively while for Potential Angle investors questionnaires were used. The summary of the criteria that commercial banks, micro financial institutions and potential angel investors use to select and provide finance for businesses are presented below.

4.4.1. Existing and traditional sources of finance

The existing and traditionally sources of finance for businesses that are at idea, start up and existing level found in Ethiopia are commercial banks and micro financial institutions. The interviews that were conducted by the researcher are put as follow in to two parts.

4.4.1.1. Criteria of commercial banks

Ethiopian Commercial and Abay banks were the commercial banks that have been selected to conduct the interview. Interview with their loan managers were conducted and their responses were very much similar and is put as follow.

- The first point of the interview was the firm's age and the business owner's age that they consider while loaning: the business must be 2 years and the owner must be 18 years old and above to be illegible even to start the process of accessing finance from them.
- The second point, what is the amount of finance that the bank provides: it is depending on the proposal and equally it depends on the collateral that they provide for the amount of finance that is requested.
- The third point of discussion was about interest rate, the cost of the finance that they set for the finance that is provided to any business is between 11.5% and 19.5%.
- The fourth point was regarding to the types of business activities that the bank favors: currently the government put first businesses that are engaged on exporting and put on hold for the business that are not due to the current condition that the country is facing. However before this current condition business who are engaged on manufacturing and construction were given priority.
- The fifth point of discussion was about the criteria that the bank uses to provide loan: The criteria that they use are what commonly called 5Cs, which are collateral, capacity, capital condition and character.
- For the question of what are the most 3 common reasons for rejecting a loan is lack of adequate collateral, inadequate capital and poor character: poor quality of financial statements any record for that matter are the most common reasons for rejecting loan application.

And the last point that was discussed was, from the bank experiences out of 10 MSE's loan applications that are at an age of less than two years are totally rejected and for those who are above 2 years 8 out of 10 are rejected due to the reasons of lack of adequate collateral and inadequate capital.

4.4.1.2. Criteria of Micro Financial Institutions

Meklit and Addis Micro and finance were the micro financial institutions that have been selected to conduct the interview. Interview with their loan managers were conducted and their responses were very much similar and is put as follow.

- The first point of the interview was the firm's age and the business owner's age that they consider while loaning: the business must be 6 months and the owner must be 18 years and above to be illegible even to start the process of accessing finance from them.
- The second point, what is the amount of finance that the micro finance provides: for the first round they can access up to 50,000 birr then on the second round they can take up to 100,000 birr. On both round the collateral has to be adequate and for the second round the repayment history of the first round will be a determinant factor for the second round and the rest if there will be any. Without this for the beginning it is 50,000 birr only.
- The third point of discussion was about interest rate, the cost of the finance that they set for the finance that is provided to any business is between 17% and 24%.
- The fourth point was regarding to the types of business activities that the bank favors: all business activities will be considered equally.
- The fifth point of discussion was about the criteria that the bank uses to provide loan: The criteria that they use are what commonly called 5Cs, which are collateral, capacity, capital condition and character.
- For the sixth point of discussion, of what are the most 3 common reasons for rejecting a loan is lack of adequate collateral, inadequate capital and poor character: poor quality of financial statements any record for that matter are the most common reasons for rejecting loan application.

And the last point that was discussed was, from the micro finance experiences out of 10 MSE's loan applications 3 out of 10 are rejected due to the reasons of lack of adequate collateral and inadequate capital.

4.4.2. Alternative sources of finance

4.4.2.1. Criteria of Potential Angel Investment

Potential angel investors were asked to prioritize their investment criteria to invest on idea level, start up and existing business and their answers are summarized on the following tables.

Trustworthiness of business owner(s): is about the quality of communication between the business owner and the angel investor in every interaction they do. If the communication is put up well then the trust will strengthen the interest of the angel to invest. The sampled potential angle investors were asked to prioritize trustworthiness of a business owner, and their answer is displayed on table 4.21.

Table 4.21: Trustworthiness

Sources of finance	Not important		Important		Very Important	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Idea level	0	0%	0	0%	73	100%
Start up	0	0%	0	0%	73	100%
Existing	0	0%	0	0%	73	100%

Source: Research questionnaire

As it shown on table 4.21, trustworthiness of a business owner as investment criteria is considered by 0 or 0% as not important, 0 or 0% as important and 73 or 100% as very important for businesses found at idea level, start-up and existing level. This implies that trustworthiness is taken as very important investment criteria by all sampled potential angel investors.

Collateral, refers to the amount of assets need to be put as a guarantee. Respondents were asked how they prioritize collateral as an investment criterion and their answers put as follow.

Table 4.22: Having collateral

Sources of finance	Not important		Important		Very Important	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Idea level	64	87.7%	9	12.3%	0	0.0%
Start up	49	67.1%	14	20.5%	10	13.6%
Existing	35	47.9%	27	38.4%	11	15.1%

Source: Research questionnaire

From the above table 4.22, having collateral by the business owner as investment criteria is considered by 64 or 87.7% as not important, 9 or 12.3% as important and 0 or 0% as very important for businesses found at idea level. For Start-up businesses having collateral is considered by 49 or 67.7% as not important, 14 or 20.5% as important and 10 o4 13.6% as very important while of existing level businesses considered by 35 or 47.9% as not important, 27 or 38.4% as important and 11 or 15.1% as very important. Based on the data displayed on table 4.22 the majority of the respondents do not consider having collateral as important investment criteria for a business found at idea level, while it is true for business found at start up and existing level. This implies luck of collateral by businesses will not affect them to use angel investment as new and alternative source of finance.

Management team; is about the relatedness of education background and experience of the management team for the project. The owners might not have all the team members in place but their understanding of the need is expected and put under the point of management team.

Table 4.23: Management team

Sources of finance	Not important		Important		Very Important	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Idea level	0	0%	60	82.2%	13	17.8%
Start up	0	0%	67	91.8%	6	8.2%
Existing	0	0%	70	95.9%	3	4.1%

Source: Research questionnaire

From the above table 4.23,having proper management team or plan for it by the business owner as investment criteria is considered by 0 or 0% as not important, 60 or 82.2% as important and 13 or 17.8% as very important for businesses found at idea level. For Start-up businesses having collateral is considered by 0 or 0% as not important, 67 or 91.8% as important and 6 or 8.2% as very important while of existing level businesses considered by 0 or 0% as not important, 70 or 95.9% as important and 3 or 4.1% as very important. This implies the majority of the respondents consider having management team is important.

Perceived financial rewards (for investors), is about the perceived financial reward as primary motivating factor to participate on angel investment. There might be different and other factors that motivate a person to take place in angel investment however, financial rewards as primary motivating factor is considered under this topic for the angels. Respondents were asked to prioritize perceived financial rewards as investment criteria on MSEs found at idea, start up and existing level and their responses are put on the following table.

Table 4.24**:** Perceived financial rewards (for investors)

Sources of finance	Not important		Important		Very Important	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Idea level	3	4.1%	60	82.2%	10	13.7%
Start up	22	30.0%	42	57.5%	9	12.0%
Existing	3	4.1%	3	4.1%	67	91.8%

Source: Research questionnaire

From the above table 4.24, having collateral by the business owner as investment criteria is considered by 3 or 4.1% as not important, 60 or 82.2% as important and 10 or 13.7% as very important for businesses found at idea level. For Start-up businesses having collateral is considered by 22 or 30% as not important, 42 or 57.5% as important and 9 o4 12% as very important while of existing level businesses considered by 3 or 4.1% as not important, 3 or 4.1% as important and 67 or 91.8% as very important. The data displayed on table 4.24 shows that for idea level and start up level perceived financial reward is not a very important investment factor while it is for existing level MSEs.

Potential exit routes (liquidity), is about the proper way of departing from the business and departing is possible basically through exit or liquidity event. This event has to be accompanied safely when the legal frame work supports and assure being practiced in the country. Sampled Potential angel investors were asked to prioritize the availability of liquidity to their investment criteria and their response is as follow.

Table 4.25**:** Potential exit routes (liquidity)

Sources of finance	Not important		Important		Very Important	
	Frequency	Percent (%)	Frequency	Percent (%)	Frequency	Percent (%)
Idea level	0	0.0%	0	0.0%	73	100.0%
Start up	0	0.0%	0	0.0%	73	100.0%
Existing	0	0.0%	0	0.0%	73	100.0%

Source: Research questionnaire

As it shown on table 4.26, exit of a business owner as investment criteria is considered by 0 or 0% as not important, 0 or 0% as important and 73 or 100% as very important for businesses found at idea level, Start-up and existing level. This implies that availability of exit route or liquidity is taken as very important investment criteria by all sampled potential angel investors.

The average amount of finance

Sampled potential angle investors were asked the average amount of finance that they invest per MSE that is found at idea; Start-up and existing level and their answers are put as on the following tables.

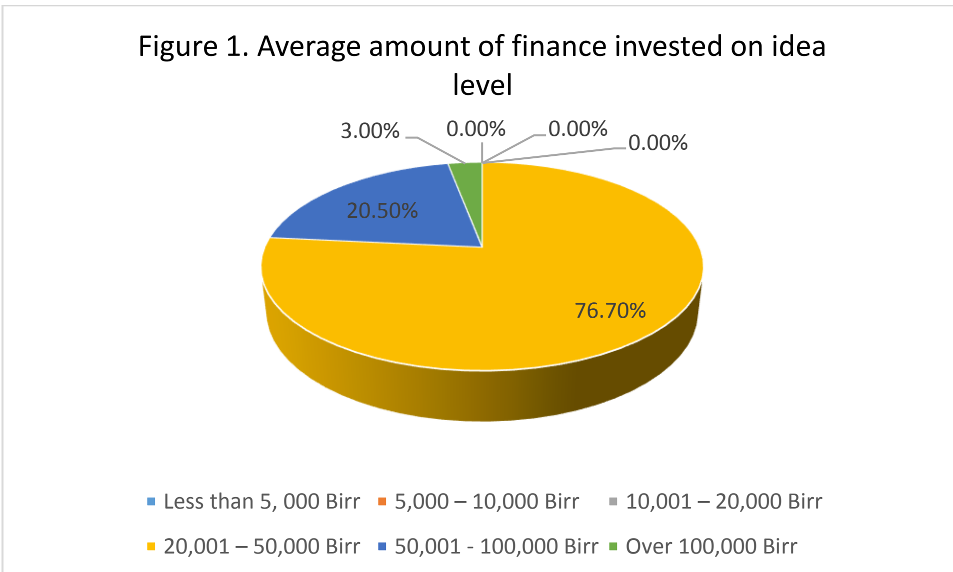
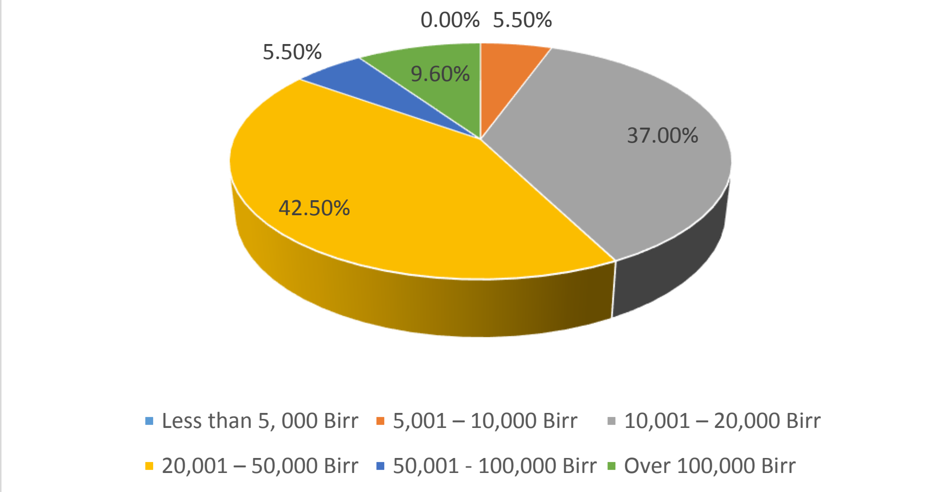


Figure 1. Average amount of finance invested on idea level

Source: Research questionnaire

0 or 0% sampled potential investors would invest less than 20,000 Birr, 56 or 76.7% invest between 20,001 and 50,000 Birr, 15 or 20.5% between 50,001 and 100,000 Birr and 2 or 3% would invest above 100,000 Birr on an idea level business. This means for idea level businesses angel investment can an alternative source of finance.

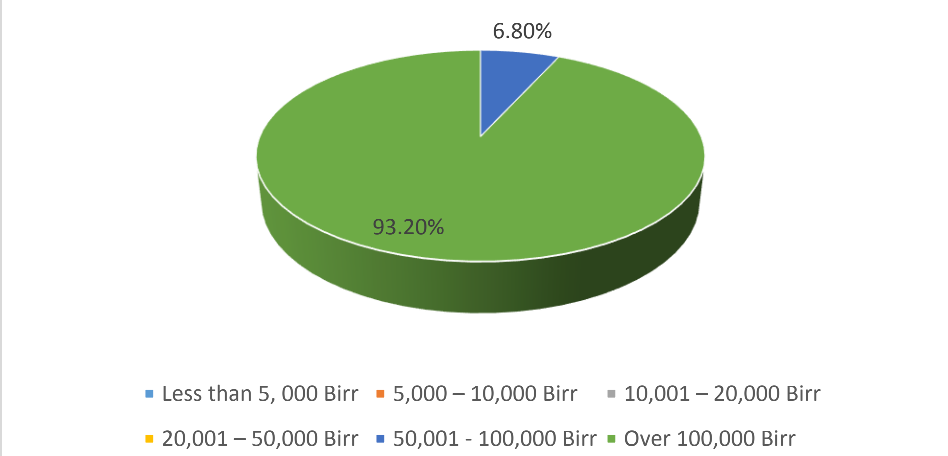
Figure 2. Average amount of finance invested on Start-up



Source: Research questionnaire

0 or 0% sampled potential investors would invest less than 5,000 Birr, 4 or 5.5% invest between 5,001 and 10,000 Birr, 27 or 37% between 10,001 and 20,000 Birr, 31 or 42.5% between 20,001 and 50,000 Birr, 4 or 5.5% between 50,001 and 100,000 Birr and 7 or 9.6% would invest above 100,000 Birr on a startup business. This means for idea level businesses angel investment can an alternative source of finance.

Figure 3. Average amount of finance invested on Existing Businesses



Source: Research questionnaire

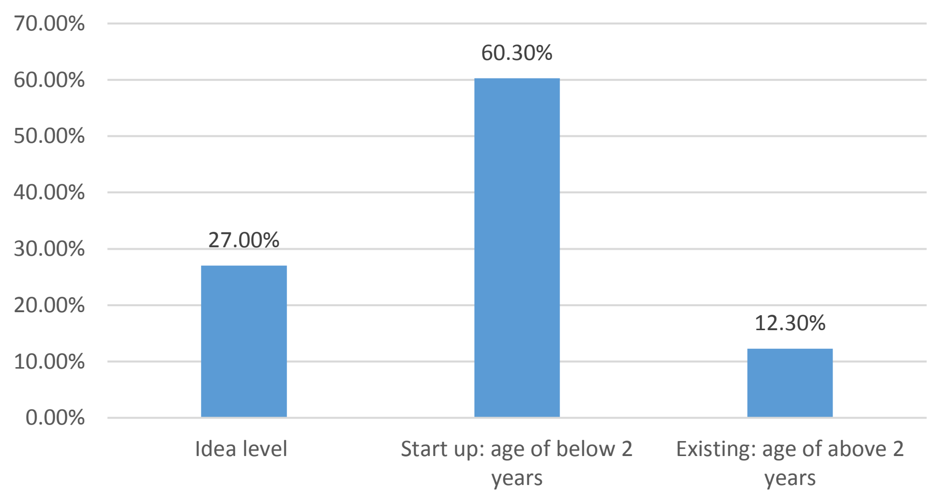
0 or 0% of sampled potential angle investors would invest less than 50,000 Birr, on average amount of financial invested 10 or 6.8% between 50,001 and 100,000 Birr and 68 or 93.2% would

invest above 100,000 Birr on an existing business. This data reveals angle investment which is under equity financing option is willing to invest on existing businesses with more than 100,000 Birr.

The firm age that the investors would consider investing on

Sampled Potential angel investors were asked the level of firm that they would consider to invest on and their answer is displayed on the following table

Figure 4. Preferred MSE’s age



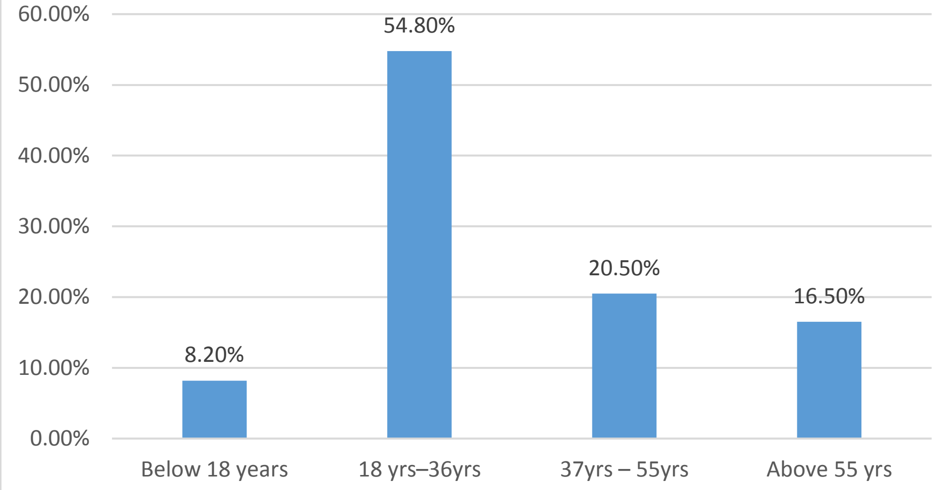
Source: Research questionnaire

As it shown on figure 4, 20 or 27% of the sampled potential angle investors consider to invest on idea level, 44 or 60.3% on Start-up who are at an age of below 2 years and 9 or 12.3% on existing level of businesses. This data reveals angle investment which is under equity financing option does give a shoot to businesses that are at idea level.

The preferred age of business owner

Sampled potential angle investors were asked to answer the age group of the business owner that they would prefer to invest on and the answer is put on the following table.

Figure 5. Preferred MSEs owner's age



Source: Research questionnaire

On the above figure the sampled 6 or 8.2% potential angle investors preferred to invest on business owners who are below 18 years, 40 or 54.8% with an age found between on 18 years and 36 years, 15 or 20.5% on an age found between 37 years and 55 years and 12 or 16.5% on an age who is above 55 years old. This means that the potential angle investors would give a chance by investing on business that is owned by younger people.

Chapter Five

5. Findings, Conclusions and Recommendations

The purpose of this chapter is to summarize the major findings, conclude and recommend to the stakeholders and future research directions

5.1 Findings

The theme of this study which is "the financing option for MSEs from inception to operation in Ethiopia" sort to highlight the alternative and new innovative source of financing option, angle capital market, can be another source of finance for idea level, Start-up s and existing MSEs in Ethiopia. In achieving this, the study sort to answer the following objectives

- To describe the previously accessed sources of finance by MSEs,
- To describe the current sources of finance being accessed by MSEs,
- To describe the future usage of sources of finance by SMEs, the followings were discovered from the
- To examine the extent how MSEs fulfil collateral, capacity, capital, condition, character, documentation, proposal and interest rate requirements that commercial banks put upfront to be used as a source of finance in Ethiopia,
- To examine the extent how MSEs fulfil the collateral, capacity, capital, condition, character, documentation, proposal and interest rate requirements that micro financial institutions put upfront to be used as a source of finance in Ethiopia,
- To examine the extent how MSEs fulfil the trustworthiness, collateral, management team, perceived financial reward and potential exit routes (liquidity) requirements that potential angel investors put upfront for accessing finance in Ethiopia,

Based on the responses received through the questionnaires circulated, it became evident that MSEs in Ethiopia from inception to operation used different sources of finance to access finance primarily from their personal and partners' saving (100%), secondly from loan from family and friends (65.9%, thirdly from Iqub (37.7%) followed by MFIs (10.5%) and finally the least source of finance that MSEs found in Ethiopia use as a source of finance is commercial banks (0%).

Further the study reveals that MSEs found at all level in Ethiopia are currently using the followings sources of finance in order, Iqub (43%), personal and partners' contribution (34.1%), loan from families and friends (13%), micro finance institutions (9.5%) and commercial banks (0%).

To describe the future usage of sources of finance by MSEs in Ethiopia who had growth expectations intersected with their previous experience on the process of using different sources of finance it was found out that:

MSEs found collateral to be 100% an obstacle factor to use **commercial banks** as their sources of finance with equivalent tone by capacity factor and followed in order by capital (15.8%), character (8.5%), bad condition (0%), documentation (0.3%), proposal (0%), pervious record (100%), interest rate (67.5%), ownership and availability (0%).

MSEs found collateral to be 89.1% an obstacle factor to use **micro financial institutions** as their sources of finance followed in order by capacity (24%), capital (15.8%), character (7.9%), bad condition (0%), documentation (0.3%), proposal (0%), pervious record (100%), interest rate (100%), ownership and availability (0%).

MSEs found trust worthiness to be (100%), availability (100%) and potential exit route (liquidity) (100%) obstacle factors to use **potential angel investors** as their sources of finance followed in order by perceived financial rewards (39.2%), ownership (21.3), management team (10.1%), collateral (4.5%).

5.2 Conclusions

This section presents the conclusion drawn from findings of the study. Based on the analysis made in chapter three the following conclusions are made on the financing options for MSEs from inception to operation in Ethiopia. <u>This study addresses an important gap in current academic literature on new alternative and innovative source of finance namely angel investment</u>. This study surveyed the demand side: MSEs in five major regions and one administrative cities and supply side: commercial banks, micro financial institutions and potential angel investors to describe the previous, current and future sources of finance that could be accessed by MSEs. In addition, the study examines the extent how MSEs fulfill the requirement from the traditionally existing sources of finance and from the new alternative and innovative sources of finance.

It has already been observed from the aforementioned discussion that private and partners' saving, families and friends, Iqub, commercial banks, micro financial institutions are existing and traditional sources of finance for MSEs from inception to operation in Ethiopia. The other alternative and innovative source of finance that had MSEs from inception to operation witnessed to use as a source of finance is angel investment.

The current study further showed that despite the existences of supports from different bodies to MSEs, lack of collateral, bad previous record and high interest rate, are the major obstacle factor that still inhibit them to use the existing and traditional sources of finance namely commercial banks and microfinance institutions. On the other hand the new alternative and innovative source of finance make those above-mentioned obstacle factors from the existing and traditional source of finance reasonably low and affordable for MSEs found at idea, start up and existing level to access finance.

However, ownership, availability and exiting route (liquidity) are the obstacle factors which are found under the new alternative and innovative source of finance for Ethiopian's MSEs found at all level.

In general, the study concluded that the new alternative and innovative source of finance, angel capital market, is more accessible source of finance from the existing and traditional source of finance to MSEs found in Ethiopia from inception to operation.

5.3. Recommendations

This Based on the findings of the study the following recommendations are made by the researcher. For across the range of data analyzed, the report underlines common obstacles for the MSE sector to fully reap benefits of the new alternative and innovative source of finance namely the angel capital market. For policy makers and stakeholders, addressing these challenges is crucial if the angel investment needs to serve MSEs as source of finance.

The regulatory framework is a key enabler for the development of angel capital market that implies a greater risk for investors than the traditional debt finance. Thus designing and implementing effective regulation, with investors' protection and the opening of new alternative and innovative source of finance for MSEs, represents a crucial recommendation for policy makers and regulatory authorities.

The policy mix that should be design for the angel investors' such as tax incentives, direct investment and co-investment support to industry networks and associations to speed up the practice of angel investment.

Policy makers should place increasing attention on this new alternative and innovative source of finance as a way to mobilize financial resources and entrepreneurial expertise towards innovative ventures.

The limited awareness and understanding about alternative source of finance on the part of the MSEs and potential angel investors limits the existence and practice of the instrument. From both, demand and supply side, trainings on specific skill like valuation and negotiation and from demand side business plan preparation, presentation and strategic vision, while for supply side specifically an effort to target training, mentoring and coaching are needed. FeMSEDA at a federal level and ReMSEDA, at specific region level, should work on providing training on these specific skills developments beside what they are offering.

The above mentioned limitations lead to possible future research directions. This thesis only focused on the financing options for MSEs from inception to operation in Ethiopia. So, overall sources of finance for private sector in Ethiopia is remain unknown. Investigating the financing option in large enterprises provides another area of future research

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Annex 1 SMEs survey instrument (English version)

QUESTIONNAIRE

St. Mary's University

School of Graduate Studies

MBA Program

Dear Respondents

The objective of this questionnaire is to secure the necessary and relevant first-hand information that may be useful to conduct a Thesis regarding "Assessment of Financing Options For Small and Micro Enterprises From Inception To Operation In Ethiopia" which will be used to prepare a Thesis required for my MBA. Therefore, your response in this regard helps a lot to undertake the study.

In the space provided below, I would like to know your address for possible contact in the future, however, feel free to leave it empty if you wish not to mention it.

The result of this survey will be treated with at most confidentiality and will be strictly used for academic purpose only, there is no "right" and "wrong" answer. The researcher thus appreciates in advance for your cooperation and sparing your valuable time in filling this questionnaire (responding to the questions).

Questions to befill by MSE owner/ Managers

Instruction; Pleaseput "□" markonthebox youneedto chooseandyoucanchoose more thanoneanswer (ifany).

Section A: GENERAL INFORMATION OF THE COMPANY and the owner

1. COMPANY PROFILE
   1.1. Number of employees
      1. ☐ 1-5   2. ☐ 6 - 10
   1.2. Types of activity
      1. ☐ Manufacturing   4. ☐ Construction
      2. ☐ Service   5. ☐ Agriculture (Urban)
      3. ☐ Commerce & trade
2. What is the age of your firm?
      1. ☐ Idea level

2. ☐ Newly existed business

3. ☐ Business with an age of up to 2 years

4. ☐ Business with an age of above 2 years

Section B:

3. From which source of finance have you applied over the past 6 months?

Source of finance	Requested & granted	Requested & not granted	Did not request
Commercial banks			
Micro finance Institution			
Personal savings and Partners' contributions			
Families and friends			
Iqub			

3.1. If your answer for question #4 is "Requested and granted", did you receive partly or fully the finance that you applied for?

Source of finance	Yes, I have received fully	Yes, I have received partly
Commercial banks		
Micro finance Institution		
Personal savings and Partners' contributions		
Families and friends		
Iqub		

4. From which source of finance have you applied within the last 6 months?

Source of finance	Requested & granted	Requested & not granted	Did not request
Commercial banks			
Micro finance Institution			
Personal savings and Partners' contributions			
Families and friends			
Iqub			

4.1. If your answer for question #4 is "Requested and granted", did you receive partly or fully the finance that you applied for?

Source of finance	Yes, I have received fully	Yes, I have received partly
Commercial banks		
Micro finance Institution		
Personal savings and Partners' contributions		
Families and friends		
Iqub		

5. Consider the turnover over the next two to three years, how much does your company expect to grow?
    1. ☐ Grow substantially- over 10% per year in terms of turnover
    2. ☐ Grow moderately- below 10% per year in terms of turnover
    3. ☐ Stay the same size
    4. ☐ Become smaller

6. The amount of financing that you would aim to obtain?

1.	☐ Less than 5, 000 Birr	4.	20,001 – 50,000 Birr
2.	☐ 5,000 – 10,000 Birr	5.	50,001 - 100,000 Birr
3.	☐ 10,001 – 20,000 Birr	6.	Over 100,000 Birr

7. Please prioritize the following factors that have been obstacle to access finance for your business from each source of finance.

Factors	from commercial banks				from Micro financial institution				from Angle investors			
	Not significant 1	Marginally significant2	Very significant3	Extremely significant4	Not significant	Marginally significant	Very significant	Extremely significant	Not significant	Marginally significant	Very significant	Extremely significant
Lack of collateral												
Lack of capacity to repay debt by the business												
Inadequate amount of equity invested in the business by the owner/s												
Bad conditions of the economy in which your business operates												
Lack of managerial expertise’s												
Poor documentation												
Project proposal not accepted												
Previous credit record												
High interest rate												
Reduced control over the business												
Financing option being not available at all												

<u>Annex 2</u> SMEs survey instrument (Amharic Version)

የጥናት መጠይቅ

ቅድስት ማርያም ዩንቨርስቲ

የቢዝነስና ኢኮኖሚክስ ፋኩልቲ

የንግድ አስተዳደር ትምህርት ክፍል

<u>የተከበሩ የጥናቱ ተሳታፊ</u>

የዚህ መጠይቅ ዋና አላማው ለማስተርስ ዲግሪ መመረቂያ የሚሆን ጥናት ለማከናወን አስፈላጊ እና ተዛማጅ የሆኑ መረጃዎችን ከመሰረቱ ለመሰብሰብ ነው፡፡ስለዚህም የእርሶ መልስ በዚህ ረገድ ለጥናቱ መከናወን የላቀድርሻ አለው፡፡

ከዚህ መጠይቅ የሚሰበሰቡ መረጃዎች ሚስጥራዊነታቸውን ጠብቀዉ ለትምህታዊ አለማ ብቻ እንደሚዉሉ እያረጋገጥኩ ትክክል የሆነ ወይም የተሳሳተ መልስ የሚባል መመዘኛም ሆነ የመመዘን ፍላጎት እንደሌለ ተረድተዉ በግልዎ የተሰማዎትን ምላሽ ለእያንዳንዱ መጠይቅ ሀሳቦትን እንዲያስቀምጡ በትህትና እጠይቃለሁ፡፡ ጊዜዎት ንሰውተዉ ይህንን መጠይቅ ለመመለስ ፍቃደኛ ስለሆኑ በቅድሚያ እያመሰገንኩ መልሰው ከጨረሱ በኋላ ቅፁን እዲመልሱልኝ ስል በትህትና እጠይቃለሁ፡፡

<u>የአነስተኛናመካከለኛድርጅት/ተቋማት/ የጥናትመጠይቅበንግድባለቤትየሚሞላየመጠይቅቅፅ</u>

መመሪያ፡ መልሶትንበሚመለከተውመጠይቅስርይህንን“✓” ምልክትበማስቀመጥመመለስይችላሉ፡፡

በተጨማሪምከአንድበላይየሆነመልስካሎትእንደዚውከምርጫዎቹከአንድበላይምክትማድረግይችላሉ፡፡

ክፍልአንድ፡ የርስዎናየድርጅቱጠቅላላሁኔታ

1. የድርጅትመረጃ
   1.1. የተቀጣሪሰራተኛቁጥር
      1. ☐ 1 - 5
      2. ☐ 6 - 10

   1.2. የተሰማሩበትየስራዘርፍ
      1. ☐ ማኒፋክቸሪንግ
      2. ☐ አገልግሎት
      3. ☐ ንግድ
      4. ☐ ኮንስትራክሽን
      5. ☐ ሌላካለይግለፁ..
2. የድርጅቱ ዕድሜ?
   1. ☐ በሀሳብ ደረጃ ያለ
   2. ☐ በቅርብ ግዜ የተመሰረተ
   3. ☐ ሁለት ዓመት ያልሞላው
   4. ☐ ከሁለት ዓመት በላይ የሆነው

ክፍል ሁለት፡

3. ከሚከተሉትየገንዘብምንጮችለንግድዎከየትኞቹአግኝተውያውቃሉ?

የገንዘብምንጮች	ጠይቄአውቃለሁ	አግኝቼአውቃለሁ	ተዛማጅአይደለም
ከንግድባንኮችብድር			
ከአነስተኛየገንዘብቋሞች			
ከግል			
ከቤተሰብእናከጓደኞችብድር			
ዕቁብ			

3.1. ለተራቁጥር 4 ምላሾትአዎከሆነበየትኛውየንግድደረጃ/ዕድሜላይእያሉነበር?

የገንዘብ ምንጮች	ድርጅቱከመመስረቱበፊት	ድርጅቱእየተቋቋመባለበትጊዜ	ድርጅቱተቋቁሞበማደግላይባለበትወቅት
ከንግድ ባንኮች ብድር			
ከአነስተኛየገንዘብቋሞች			
ከግል			
ከቤተሰብእናከጓደኞችብድር			
ዕቁብ			

4. ባለፉት 6ወራት ከየትኛውየገንዘብተቋም/ምንጭብድርጠይቀዋል?

የገንዘብተቋም	አዎጠይቄአለሁ	አይአልጠየኩም
ከንግድባንኮች		
ከጥቃቅንየገንዘብተቋሞች		
ከቤተሰብእናከጓደኞች		

4.1. መልስዎለተራቁጥር4**አዎጠይቄአለሁ**ከሆነየጠየቁትንየገንዘብመጠንሙሉውንነውወይስበከፊልነውያገኙት?

የገንዘብተቋም	ሙሉውንአግቻለሁ	በከፊልአግቻለሁ
ከንግድባንኮች		
ከጥቃቅንየገንዘብተቋሞች		
ከቤተሰብእናከጓደኞች		

5. ለሚቀጥለውከሁለትእስከሦስትአመትያለዉንየገቢመጠንበማገናዘብ፣ ድርጅቶበምንያልያድጋልብለውዴጠብቃሉ?

5. ☐ የላቀእድገት - በአመት ከ10% በላይየሆንበገቢእድገት
6. ☐ መጠነኛእድገት - በአመት ከ10% በታችየሆንበገቢእድገት
7. ☐ ተመሳሳይበሆንበገቢመጠንመቆየት
8. ☐ ከነበረውየገቢመጠንመቀነስ

6. ወደፊትለንግድዎሊገኙትየሚፈልጉትየገንዘብመጠንምንያህልይሆን?

4. ☐ ከ 5, 000 ብርበታች	4. ☐ 20,001 – 50,000 ብር
5. ☐ 5,000 – 10,000 ብር	5. ☐ 50,001 - 100,000 ብር
6. ☐ 10,001 – 20,000 ብር	6. ☐ 100,000 ብርበላይ

7. ለንግድዎየሚያስፈልጎትየገንዘብመጠንከሚከተሉትየገንዘብምንጮችሊያገኙእንደሚችሉቢያዉቁ፣ እንደዋነኛመሰናከልየሚሆኑትንበቅደምተከተልያስቀምጡት?

መስፈርቶች	ከንግድባንኮች				ከጥቃቅንየገንዘብተቋሞች				ከኢንቬስተሮች			
	ምንም ተፅኖ የለውም	መለስተኛ ተፅኖ አለው	በጣም ተፅኖ አለው	እጅግ በጣም ተፅኖ አለው	ምንም ተፅኖ የለውም	መለስተኛ ተፅኖ አለው	በጣም ተፅኖ አለው	እጅግ በጣም ተፅኖ አለው	ምንም ተፅኖ የለውም	መለስተኛ ተፅኖ አለው	በጣም ተፅኖ አለው	እጅግ በጣም ተፅኖ አለው
በቂ የሆነ የንብረት ማስያዣ አለመኖር												
ንግዱ ብድሩን የመክፈል አቅም አለመኖር												
በንግዱ ባለቤት የሚጠበቅበትን ቅድመ ቁጠባ አለማድረግ												
ንግዱ እየተከናወነ ባለበት ሁኔታ ያለው ሁኔታ መጥፎ መሆን												
የአስተዳደርብቃትያለውባለሙያአለመኖር												
ከፍተኛየወለድመጠን												
በድርጅቱ ላይ ያለ ቁጥጥር ስልጣን ስለሚቀንስ												
ይህየገንዘብምንጭአለመኖር												

Annex 3 Potential Angle Investors survey instrument (English version)

QUESTIONNAIRE

St. Mary's University

School of Graduate Studies

MBA Program

Dear Respondents

The objective of this questionnaire is to secure the necessary and relevant first-hand information that may be useful to conduct a Thesis regarding "Assessment of Financing Options For Small and Micro Enterprises From Inception To Operation In Ethiopia" which will be used to prepare a Thesis required for my MBA. Therefore, your response in this regard helps a lot to undertake the study.

In the space provided below, I would like to know your address for possible contact in the future, however, feel free to leave it empty if you wish not to mention it.

The result of this survey will be treated with at most confidentiality and will be strictly used for academic purpose only. The researcher thus appreciates in advance for your cooperation and sparing your valuable time in filling this questionnaire (responding to the questions).

Questionsto befill by Potential Angle Investors

Instruction; Pleaseput"□" markonthebox youneedto chooseandyoucanchoose more thanoneanswer (ifany).

1. What firm age would you consider to invest on MSEs?
   1. ☐ Idea level
   2. ☐ Business with an age of up to 2 years
   3. ☐ Business with an age of above 2 years
2. What is the preferred age of business owner that you would invest on?
   1. ☐ Below 18yrs
   2. ☐ 18 yrs – 36yrs
   3. ☐ 37yrs – 55yrs
   4. ☐ Above 55 yrs

3. Please prioritize your investment criteria to MSEs found at different (idea, start up and existing) level.

Investment Criteria	**Idea level**			**Start up**			**Existing**		
	Not important	Important	Very Important	Not important	Important	Very Important	Not important	Important	Very Important
Trustworthiness of business owner(s)									
Having collateral									
Management team									
Perceived financial rewards (for investors)									
Potential exit routes (liquidity)									

4. What is the average amount of finance you would invest per MSE that is found at different (idea, start up and existing) level?

No	Average amount	Idea level	Start-up level	Existing level
1	Less than 5, 000 Birr			
2	5,000 – 10,000 Birr			
3	10,001 – 20,000 Birr			
4	20,001 – 50,000 Birr			
5	50,001 - 100,000 Birr			
6	Over 100,000 Birr			

Annex 4 In-depth interviews questions (English version)

ANNEXES 3

In-depth interviews questions

St. Mary's University

School of Graduate Studies

MBA Program

1. What business age and business owner's age does your bank/MFI consider while loaning to MSEs?
2. What is the amount of finance that your bank provides?
3. What is the interest rate?
4. What type of business activities of a business does your bank prefer to invest on?
5. What are the criteria that your bank/MFI uses to provide loan?
6. What are the most common reasons for rejecting a loan application?
7. In your experience, out of 10 MSE loan applications received, how many are rejected?
8. What are the most common reasons for rejecting a loan application?