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Title of the project: **Access to Finance and its Challenges for Private sector in Ethiopia**

(By the supervisor)

I hereby certify that the proposal for the project entitled: **Access to Finance and its Challenges for Private sector in Ethiopia** by **Firewoini Gebrevesus Menkir**, has been prepared after due consultation with me. I agree to supervise the above mentioned project till its completion.

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1. Introduction

Most growth theories such as, Paul and Frederic (2000), imply that private sector is a carrier of economic growth of any country by involving highly on the industrialization process and other sectors of the economy. For a developing country such as Ethiopia, whose economy is still predominantly agrarian, the private sector plays a vital role in the overall economic growth of the country. As indicated by Alemayehu, Geda; (2004); the role of private businesses in Ethiopia is becoming an instruments of employment and income generation, human development and poverty alleviation, export promotion, import substitution and entrepreneurship and hence the driving forces behind the growth of the country economy. Therefore, policies and initiatives to develop private businesses and to increase their competitiveness are a priority for Ethiopia. The government in its recent important policy-cum-plan documents unequivocally clearly stated about the importance it attaches to the development of the private sector.

But, the private sector development in Ethiopia is still at low level owing to its internal weakness and other constraints. Several studies on problems of private sector development in Ethiopia (Ethiopian Investment Commission, 2014; Ethiopia Chamber of Commerce and sectoral association, 2010, World Economic Forum, 2014) for instance, revealed that Private entrepreneurs' limited access to credit is reported to be the most pressing and binding constraint for doing business in Ethiopia.

The focus of this paper is to evaluate access to finance that these private enterprises in Ethiopia are having and the factors that hinder them not to properly raise fund is going to be assessed. Finance is the core element of any investment process. Investment in any productive sector is very much essential for the growth of industry and increased facilities in obtaining finances can

in return enhance that growth. Finance is needed at the opening phase of a business as well as at the continuing phases.

It is widely recognized that there is a pressing shortage of loan funds in Ethiopia. This is, to a certain extent, a result of Government regulations that oblige private commercial banks to buy government bonds equivalent to 27% of each loan made (IFC Getting Credit indicator, 2014). The second constraint to access to finance is high collateral requirements (120%), (World Economic Forum, 2014). The third hampering element is the fact that international supplier credit is rarely allowed. There is also a problem of extending medium to long-term loans; banks are very reluctant to extend loans for long and medium term development activities and they tend to exclude small borrowers and concentrate on their wealthy clients that are creditworthy (Ethiopia Chamber of Commerce and sectoral association, 2010).

Financial sector strength and private sector development are found to be different sides of the same coin as far as their growth is concerned. One of the functions of financial institutions mobilizing resources, particularly savings, is carried out with the ultimate objective of channeling financial resources to would-be investors. In line with this and to assess whether the Ethiopian financial sector is adequately serving the private sector, the strengths and the weaknesses of all financial institutions should be scrutinized. The financial sector needs to be strengthened and ultimately stand on its own so that it can adequately serve the private sector.

1.1. Statement of the problem

It is now recognized that the private businesses are playing and have become an increasingly important contributor to Ethiopia's economy. The contribution of the private businesses in both agriculture and industrial sector to the country's gross domestic product is continuously increasing. The sector contributes to the national objective of creating employment opportunities, income generation, human development, poverty alleviation, export promotion and providing a source of livelihood for the majority of own income households in the country (Eshetu and Mammo, 2009). Had this sector been provided proper emphasis, the sector has a high potential for contributing to meet the objective they were envisaged for. Yet stringent collateral requirements to get access credit from banks are the major impediments for majority of business entrepreneurs. While there are a number of constraining factors obstacle development private firms in Ethiopia, the basic and the one that seek attention is access to finance (IFC Getting Credit indicator, 2014)

Improving the availability of finance facilities to this sector is one of the incentives that have been proposed for stimulating its growth and the realization of its potential contribution to the Ethiopian economy but, the need of private business for finance became higher and complicated when they grow and involve in high dynamic activities. Despite this emphasis, the effects of existing institutional problems, especially the lending terms and conditions on access to credit facilities, have not been addressed yet in the country. In addition, there is no empirical study indicating the potential role of improved lending policies by the financial institutions in alleviating problems of access to finance. Knowledge in this area, especially a quantitative analysis of the challenges private business facing in access finance is lacking for the financial markets of Ethiopia.

Financial sector strength and private sector development are found to be different sides of the same coin as far as their growth is concerned. One of the functions of financial institutions mobilizing resources, particularly savings, is carried out with the ultimate objective of channeling financial resources to would-be investors. But, it can be said that Ethiopian privately owned banks and Micro Financial Institutions are hampered by insufficient capital and limited operational scale. Despite a growing number of Financial Institutions, credit provision remains well below the country's private enterprise investment needs. To meet the objective for which these private enterprises are established, this challenge should be alleviated. Therefore the researcher wants to see the following main issues:

1. What are the barriers faced by private sector operators in accessing adequate finance?
2. What are the general government policies affecting the operations of banks and other financial intermediaries?
3. What and how appropriate policies and regulatory measures can alleviate the problem?

1.2. Objectives of the study

The overall objective of the paper is to provide a "better understanding of the policy as well as regulatory triggers and incentives that will encourage formal financial institutions to deepen outreach to the Ethiopian private sector"

To achieve this overall objective, the paper will have three specific objectives, namely:

1. A review the Ethiopian financial sector and the barriers faced by private sector in accessing adequate finance;
2. The identification of policies and regulatory issues that determine access to finance for private sector engagements; and
3. Identification of appropriate recommendation to alleviate the constraint.

1.3. Significance of the study

This research paper is assumed to be conducted for the following significance expectation.

- To provide hints as to how the private sector is overcoming the constraints associated with access to finance
- To use the suggestions and recommendations that will forward in this paper for further private sector development activities.
- The paper will also provide insight for further study in the subject under consideration

1.4. Scope of the research

The paper will take into consideration a various findings linked to the access to finance concept, including analyzing the wide range of functions typically discharged by the financial sector, exploring issue of government policies prevailing in related areas possibly affecting financial markets and transactions and the introduction of instruments currently not in use in the country for possible solutions.

1.5. Methodology

The purpose of this paper is to provide better understanding one of the major basics, namely financial aspects, of the private enterprise sector in pursuing rapid economic growth. In addition to the assessment of the access to finance provided to the private enterprise in the country, this paper will focus on various other financial aspects so as to provide recommendations. For this purpose, extensive survey of literature of relevant publications, previous studies and various initiatives taken by the stakeholders (including the government and the development partners) will be reviewed.

A research method can be either qualitative or quantitative. To address the research questions about access to finance for private sector development on the Ethiopian context, this research will use both qualitative and quantitative approach.

1.5.1. Data Type and Data Source

Both primary and secondary data will be used to conduct the research. The primary data the researcher use will be data from target group means the owner and/or managers of the business enterprises.

The secondary data that the researcher will use are from varies secondary sources i.e., Periodic government body's publications, report of development partners, relevant publications and previous studies will be the main secondary sources.

The data (primary data) concerning the main issues of the research will be collected using questionnaires. The questionnaires will be distributed to private business owner and/or managers operating in Addis Ababa on the basis of judgmental sampling.

1.5.2. Sampling technique

The researcher identifies the populations to conduct the research on will be the private businesses operating in the capital city, Addis Ababa. To improve representativeness of the sample the researcher will use judgmental sampling technique.

1.5.3. Method of data analysis and Interpretation

The researcher will use descriptive data analysis method. After all relevant data collected, data preparation including editing, coding, and data entry will be made. Preparing a descriptive statistical summary and using statistical instrument like measures of central tendency and

measure of variability will be another preliminary step that the researcher conducts for understanding the collected data. To facilitate interpretation process of the research data, the researcher will use frequency tables, graphs, and pie charts.

1.6. Expected outcome:

By providing a better understanding of the policy as well as regulatory initiatives and incentives that will encourage formal financial institutions to deepen outreach to the Ethiopian private sector, the research paper will expect to provide as a major input to foster a constructive dialogue among relevant stakeholders interested in the private sector development in Ethiopia.

1.7. Organization of the paper:

The research paper will be structured as follows: chapter one will provide the introduction mainly the specific statements of the problems and methodology part of the study, with the descriptions of objectives, significant, expected outcome and scope of the study; chapter two will focus on the empirical literature parts of the study which will provides a presentation of countries financial institutions performance and of key recent developments; chapter three will deals with analysis of the access to finance constraints faced by the private sector and chapter four will summarizes key findings of the study and will includes a series of recommendations for actions that can improve the situation.

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