



Review on Factors Affecting the Performance of Micro and Small Enterprise (MSE) in Ethiopia

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Abstract

Micro and small businesses have a significant role in raising the living standards of entrepreneurial households by helping them to meet basic necessities such as food, education, and health care, as well as boost output, investment, and revenue. Despite their contributions, MSEs in Ethiopia face numerous challenges, and as a result, many MSEs function poorly and do not contribute as required. The purpose of this article is to examine the primary restrictions and factors affecting the performance of Ethiopian micro and small businesses. According to the studied literature, financial issues, working space issues, marketing issues, bureaucracy, talent gaps, infrastructure, and input supply issues are the key issues impeding the functioning of micro and small businesses. As a result, the government should concentrate on procedures for resolving these issues in order to improve the performance of MSEs and boost their contribution to national economic growth.

Introduction

Recognizing the importance of micro and small businesses in promoting capital formation, job creation, and economic development, many developing countries have prioritised the development of these businesses (Kamunge et al., 2014). Micro and small enterprises play a significant role in raising the living standards of entrepreneurial households by enabling them to increase basic needs such as food, education, and health care, as well as production, investment, and income. Microenterprises should use local products for greater profitability, and more support, including increased awareness and training, should be given to sustain existing ones, so that poverty can be reduced through microenterprise d. Micro and small businesses (MSEs) face numerous challenges, and as a result, many MSEs perform poorly and fail to contribute as required (Abera, 2012).

Despite the fact that micro and small businesses account for a significant share of industrial GDP and employment for the rising labour force, labour productivity has remained low and stagnant, according to Demeke et al., (2006). A large percentage of the poor work in the urban informal sector, which is characterised by low productivity and low pay. Many of the urban poor are employed in the informal economy, which includes urban agriculture and related enterprises, manufacturing and trade, hotels and restaurants.

Recognizing the importance of the sector, Ethiopia's present government released the National Micro and Small Enterprises Strategy in 1997 and formed the Micro and Small Enterprises Development Agency at the federal level in 1998. The national MSE development strategy's major goal is to provide a supportive legal, institutional, and other environment for MSE growth and development. This goal could be realised by focusing on the advancement of society's most vulnerable group (women), the provision of fee-based support services, and training support needs. MSEs were emphasised in the country's trade policy and poverty reduction strategy as a key tool for a productive and competitive private sector, as well as a way to alleviate poverty among urban people (FeMSEDA, 2007).

Despite their contribution to economic development and job opportunities, MSEs in Ethiopia face a number of challenges that limit their growth and development. Micro and small businesses have experienced limited growth and performance due to a variety of causes. This report aims to review significant constraints/factors affecting the performance of micro and small firms in Ethiopia in order to better understand the situation.

Body of Discussion

Conceptualization of Micro and Small Enterprise in Ethiopia

There is no commonly acknowledged definition of micro and small business, hence there is no clear cut definition. Micro and small businesses are classified differently in different nations based on different criteria. MSEs have been defined all around the world based on the number of employees, capital investment, or both. Similarly, there is a lack of a unified definition of MSEs at the national level in Ethiopia, preventing a shared understanding of the MSE sector.

The Ministry of Trade and Industry (MoTI) utilises capital investment as one criterion, whereas the Central Statistical Agency (CSA) uses employment as a criterion and prioritises capital intensive technology. The MoTI concept, which uses capital investment as a benchmark, was created in 1997 for the purpose of developing a micro and small business development strategy. Micro businesses, according to the Ministry of Trade and Industry (1997), are

Those formal and informal businesses with a paid-up capital of not more than Birr 20,000, excluding high-tech consultancy firms and other high-tech organisations. Small businesses are defined as those with a paid-up capital of more than Birr 20,000 but less than Birr 500,000, excluding high-tech consulting organisations. CSA, on the other hand, divides businesses into several sizes of operation based on the number of employees and the type of equipment used.

Small scale manufacturing firms, according to the CSA (1999), are those that employ fewer than ten people and use motorised equipment. Micro businesses are classified into two categories: informal sector operations and cottage industries: The informal sector is defined as household type establishments or activities, which are non-registered companies and cooperatives operating with less than 10 people. Cottage and handicraft industries are those establishments that perform their activities by hand and using non-power driven machines, whereas the informal sector is defined as establishments that perform their activities by hand and using non-power driven machines.

Micro enterprises are defined as businesses with five employees, including family members, and a total asset of less than Birr 100,000 for manufacturing businesses and Birr 50,000 for service businesses, while small businesses are defined as businesses with six to thirty employees and a total capital of less than Birr 1.5 million

for manufacturing businesses and Birr 500,000 for service businesses, according to the current definition (FeMSEDA, 2011).

Development Strategy of Ethiopia toward Micro and Small Enterprise

The Government of the Federal Democratic Republic of Ethiopia has recognized and paid due attention to the promotion and development of MSEs for they are important vehicles to address the challenges of unemployment, economic growth and equity in the country. To this effect, the government has formulated a National MSE Development and Promotion Strategy, which enlightens a systematic approach to alleviate the problems and promote the growth of SMEs.

Micro and small enterprise development strategy in Ethiopia was launched for the first time in 1997 E.C. The primary objective of the national strategy framework is to create an enabling environment for micro and small enterprises. In addition to this basic objective of the national MSE strategy framework, the strategy is launched under the specific objectives of facilitating economic growth and bringing about equitable development, Create long-term jobs, Strengthen Cooperation between MSEs, Provide the basis for Medium and Large Scale Enterprises, Promote export, and Balance preferential treatment between MSEs and bigger enterprises. The strategy framework is designed based on a logical and integrated vision of country's economic development process. This vision sees the MSEs to play an important part in the national economy. Most important, the vision is based on the country's overall development strategy of ADLI and the adoption of the market economic system, where the private sector will take the lead (MoTI, 1997).

The new MSE Strategy by FeMSEDA (2011) targets the graduates, poor and less skilled people to form cooperatives and create their own jobs. On top of providing jobs to the people, the establishments are also hoped to bring about the technological transfer and new corporate management skills to the nation. In this strategy also new set of areas are identified as requiring attention and priority from the government. These are the manufacturing sector that encompasses the majority of the previously identified areas, the service sector which is a relatively new one, though not completely new, construction sector (partly exists in the previous one), the urban agriculture sector (partly exists in the previous one), and the retail sector. The stage of growth of the MSEs is another concept included under the strategy. Accordingly, growth stage of MSEs includes; the start-up stage, the growth stage and the maturity stage.

1.1. Major Constraints Inhibiting the Performance of MSEs

MSEs in spite of their importance national economy, their growth and performance have been influenced by

different factors. So far, a number of studies have been conducted to identify factors attributed for poor performance of small and microenterprises. These factors can be categorized as internal and external. Internal factors include entrepreneurial (personal traits) and management factors (Abera, 2012). A study conducted by Worku (2009) on the efficiency of management as a determinant of long-term survival in micro, small and medium enterprises in Ethiopia revealed that high level of managerial skills significantly promotes long-term survival and profitability in small businesses and enterprises. According to his finding, managers of bankrupt enterprises do not have the experience, knowledge, or vision to run their businesses. Through his diagnoses, he found that the root cause of small firm failure was management inefficiency of owner-managers. External factors are factors external to enterprise that include marketing factors, working place factors, technology, financial factors, infrastructure, and enabling business environment.

Mensah *et al.*, (2016) ranked high cost of production, access to credit, input price variability, inadequate knowledge in business management and lack of access to reliable electricity respectively as the most critical constraints hindering the growth of micro and small scale enterprises. Kamunge (2014) in his analysis of factors affecting the performance of small and microenterprises in Limuru market found that; access to business information services, access to finance, availability of managerial experience, access to infrastructure, and government policy and regulations were major contributing factors for improvement in business performance.

Mulugeta (2008) identified internal factors such as poor record keeping, wrong pricing, negative cash flow, management problems, trouble among partners; external factors such as lack of capital, land and premises, taxation, poor market and market information, business support services as major causes of small and micro business failure in his analysis of underlying causes of micro and small business failures in Addis Ketema sub-city. Mezgebe (2012) employed binary logistic model to identify factors affecting the performance of MSEs. Accordingly, he found factors such as favorability of business environment completion, level, institutional quality, access to raw material and marketing significantly affecting MSEs performance.

Chane (2010) identified factors affecting performance of small and micro enterprises using Likert scale as economic, socio cultural and legal and administrative factors. He found that economic factors as the most binding factors affecting performance of MSEs. Ababiya (2013) employed linear regression to identify factors affecting the performance of microenterprises. According to his finding, age of the enterprise, age of the

operator, educational level of the operator, number of employees, amount of initial capital, entrepreneurial skill, and business experience of the manager, access to training, and access to market were significant variables affecting business performance (Benefit-cost ratio).

Mulatu *et al.*, (2006) identified working capital as major determinant of performance. Skills in business training and technical knowledge are lacking for the most part. Owners of small businesses lack the necessary capacity to benefit from innovative management and expand their businesses. As the small market is shared among too many operators, income earned is barely enough to meet subsistence requirement. The majority of operators have joined the enterprises for lack of better opportunity. The weak purchasing power of the rural community for the products has been identified as one of the major bottlenecks for the growth of the enterprises. In addition, the business environment is hardly conducive for their sustainable development.

Also, as stated in WB (2012); land, finance, input industries, entrepreneurship skills, worker skills, bureaucracy in registration and licensing and taxation were key factors inhibiting the performance of MSEs. The survey conducted by MUDC (2013) on Micro and Small Enterprises in selected major cities of Ethiopia identified numerous challenges encountered by the MSEs, although their extent varied across cities. Consequently, shortage of finance (42%) was principal challenge followed by lack of working premise (28.3%) and lack of access to market (18.1%) for MSEs in the regional cities. Conversely, lack of access to land was the most crucial bottleneck (26.4%) followed by problems of finance (25.6%) and access to market (25.1%) for constraining performances of MSEs in Addis Ababa. According to EEA (2015), problems related to finance, access to market and low competitiveness, business information, working premises, poor acquisition of technical skills and managerial expertise, appropriate technology, and access to quality infrastructure are causes for a fall in MSEs performance short of expectations.

Generally, most of the reviewed literatures on constraining factors affecting the growth and performance of micro and small enterprises report financial problem, working space problem, marketing problem, skill gap in entrepreneurship, infrastructure, and input supply problem as the most binding constraint inhibiting the performance of MSEs.

Summary and Conclusions

Development of MSEs has several roles in social and economic structure which includes, initiating new forms of economic activities, creation of new jobs, prevention of large scale rural migrations, increasing population's income, opening new export markets, full use of local resources, changes in life conditions and consumption patterns of the population, infrastructural development and stimulation of economic growth. Recognition of its role has led countries of the world to pay attention toward its development to influence macroeconomic variables stated above. This review explored the most pressing factors affecting the performance of MSEs in Ethiopia. Accordingly, several factors affecting the performance of MSEs have been identified in Ethiopia evidenced by different studies. According to the reviewed literatures, the major ones are financial problems, working space problems, marketing problems, bureaucracy, skill gap, infrastructure and input supply problem. Although the government has taken measures to solve this problem, the problem still continues to exist particularly with the first two. Credit provision system is based on saving capacity of MSEs and government's priority sector where 20% of credit need is compulsory by MSEs. This shows that, only those MSEs who have capacity accesses the loan. Though Ethiopian government has intervening through business development service provision, most of the studies showed as these services are not enough. To sum up, since MSEs in Ethiopia are at infant level as compared to other countries, creation of favorable business environment (nurturing of them) will enhance their performance to expected level.

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