

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

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Abstract

There is a great role of micro and small enterprises on improving the living standards of the entrepreneurial households enabling them increase basic needs such as food, education and health facilities, as well as production, investment and income. However, despite their contribution, MSEs in Ethiopia, encounter many problems and as a result, many MSEs perform dismally and fail to contribute as per requirement. This paper is intended to review major constraints/factors affecting the performance of micro and small enterprises in Ethiopia. According to the reviewed literatures, the major problems hindering the performance of micro and small enterprises are financial problems, working space problems, marketing problems, bureaucracy, skill gap, infrastructure and input supply problem. Therefore, the government should focus on mechanisms of resolving these problems in order to increase MSEs performance and make them contribute to more to national economic growth.

1. Introduction

Being cognizant of the role of the micro and small enterprises in stimulating capital formation, employment creation and economic development, many developing countries have given a due attention to the development of micro and small enterprises (Kamunge *et al.*, 2014). There is a great role of micro and small enterprises on improving the living standards of the entrepreneurial households enabling them increase basic needs such as food, education and health facilities, as well as production, investment and income suggesting microenterprises to use local products for more profitability and more support including awareness rising and training to be given to sustain the existing ones so that poverty can be reduced through microenterprise development. However, Micro and Small Enterprises (MSEs) encounter many problems and as a result, many MSEs perform dismally and fail to contribute as per requirement (Abera, 2012).

According to Demeke *et al.*, (2006), although micro and small enterprises account for a sizable proportion of the industrial GDP and employment for the growing labor force, labor productivity has been low and stagnant. A significant proportion of the poor works in the urban informal sector, which is characterized by low productivity and very low return. Within the urban informal sector, urban agriculture and allied activities, manufacturing and trade, hotels and restaurants absorb many of the urban poor.

In Ethiopia, the current government issued National Micro and Small Enterprises Strategy in 1997 and established Micro and Small Enterprises Development Agency in 1998 at federal level recognizing the significance of the sector. The primary objective of the national MSE development strategy is to create an enabling legal, institutional and other supportive environment for the growth and development of MSEs. This objective could be achieved through emphasizing the advancement of the most vulnerable group of the society (the women), the provision of support services on fee basis, and training support needs. The country's trade policy and poverty reduction strategy focused MSEs as major instrument to productive and competitive private sector and as a path to reduce poverty among urban dwellers (FeMSEDA, 2007).

MSEs in Ethiopia, despite their contribution to economic development and job opportunity, they are facing various problems that inhibits their growth and development. Different factors have contributed to low growth and performance of micro and small enterprises. Understanding the situation in this regard, this paper is intended to review major constraints/factors affecting the performance of micro and small enterprises in Ethiopia.

2. Body of Discussion

2.1. Conceptualization of Micro and Small Enterprise in Ethiopia

There is no clear cut definition of micro and small enterprise as there is no universally accepted definition of it. Different countries of the world have defined micro and small enterprise in different ways based on different criteria. All over the world, numbers of employees or capital investment or both have been used as the basis for defining MSEs. Similarly in Ethiopia, there is lack of uniform definition to which MSEs are defined at the national level to have a common understanding of the MSE sector.

The definition by Ministry of Trade and Industry (MoTI) uses capital investment on one side, while the Central Statistical Agency (CSA) uses employment and favors capital intensive technologies as a benchmark. The definition used by MoTI, which uses capital investment as a benchmark, has been developed for formulating micro and small enterprise development strategy in 1997. According to the MoTI (1997), Micro enterprises are

those businesses enterprises, in the formal and informal sector, with a paid up capital not exceeding Birr 20,000 and excluding high tech consultancy firms and other high tech establishments. Small enterprises are those business enterprises with a paid up capital of above Birr 20,000 and not exceeding Birr 500,000 and excluding high tech consultancy firms. On the other hand, CSA categorizes enterprises into different scales of operation on the size of employment and the nature of equipment.

According to CSA (1999), establishments employing less than ten persons and using motor operated equipment are considered as small scale manufacturing enterprises. Enterprises in the micro enterprise category are subdivided into informal sector operations and cottage industries: Cottage and handicraft industries are those establishments performing their activities by hand and using non-power driven machines whereas the informal sector is defined as household type establishments or activities, which are non-registered companies and cooperatives operating with less than 10 persons.

Currently revised definition, define Micro Enterprises as those enterprises having 5 workers including family members and its total asset not exceeding Birr 100,000 for manufacturing enterprises and Birr 50,000 for service providing enterprises and small enterprises as those enterprises having 6-30 workers and its total capital not exceeding Birr 1.5 million for manufacturing enterprise and Birr 500,000 for service providing enterprises (FeMSEDA, 2011).

2.2. 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.

2.3. 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.

3. 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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