

Challenges and Opportunities of MSEs in Ethiopia: A Review Paper

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Abstract

The micro and small business sector is recognized as an essential component of economic development and a crucial element in the effort to lift countries out of poverty (Wolfenson, 2007). External and internal factors are known to affect the growth of MSEs. Thus, this review provides overview of challenges, prospects and factors affecting growth of Micro and Small Scale Enterprises (MSEs). “Google Scholar” and “Science direct” search engines/databases were used to conduct the review using search keywords ‘the challenges of MSEs’, ‘the achievements of MSEs’ and, “factors affecting MSEs growth”. The 16 articles collected show that The prominent challenges listed in various studies in Ethiopia are access to finance, selling at less price compared with other similar enterprises, shortage of raw material, lack of experience in own business, limited access to markets, to premise, lack of training, cultural oppressions, high competition as a result of open entry to the business, development strategy and policy focusses on agriculture which in turn discourage MSEs operating in other sectors, unattractive market, lack of advertisement, training. shortage of electricity and unscheduled power cuts, bureaucratic working procedure, high tax, high collateral requirement, high interest rate, lack of technology, weak performance leading to absence of growth thinking challenges, starting business without conducting survey, inappropriate tenure, uncollectible receivables, lack of financial management skill and Youth’s adverse attitude towards working under umbrella of MSEs agency. On the opportunity side, studies revealed few of them including business consultation services, training for the beginners, loan facilities, moral or encouragement, peace and security, area specific features, support and reward like training, fund, and certificate play a role for expansion and growth of women entrepreneurs in particular and MSE owners in general.

Keywords: Challenges, Growth, MSEs, Opportunities

Introduction

The micro and small business sector is recognized as an essential component of economic development and a crucial element in the effort to lift countries out of poverty (Wolfenson, 2007). According to Ibrahim, Angelidis and Parsa (2008), ‘*the dynamic role of micro and small enterprises (MSEs) in developing countries as engines through which the growth objectives of developing countries can be achieved has long been recognized*’. Small businesses play an important role in the development of a country and serve as a means to sustain and grow economies. It is estimated that MSEs employ 22% of the adult population in developing countries (Fisseha, 2006).

MSEs are known by their greater utilization of local raw materials, employment generation, take part in rural and urban development, development of entrepreneurship, mobilization of local savings, linkages with bigger industries, provision of regional balance by spreading investments more evenly, provision of avenue for self-employment and provision of opportunity for training managers and semi-skilled workers (Taiwo et.al., 2012).

The developed as well as developing countries are taking extreme benefits from MSEs that enable them to accelerate their economy. They play considerable responsibility in providing further employment and conversion of economy. The roles of MSEs in the creation of productive employment are concerned with its position in the centre of the range of sizes and resource intensities in a rising economy. Accordingly developing economies have started to focus on the crucial role that MSEs can play in their development (Maad, 2008).

The issue of MSEs Development ranked first among the priorities of socio-economic development, given the growing need for employment creation and poverty alleviation (Nugent, 2001). For instance, according to some estimates, MSEs contribute to 22% of the adult population employment in developing countries. The United Nations Industrial Development Organization (UNIDO) estimates that MSEs represent over 90% of private business and contribute to more than 50% of employment and of gross domestic product (GDP) in most African countries (UNIDO, 2002). There is also an urgent need to create a strong competitive MSEs Sector that is able to play a leading role in the development process.

External and internal factors are known to affect the growth of MSEs. The most important external factors influencing growth of MSEs include access to finance, competition, limited production/market place, lack of market for the product or service; and other barriers to trade. On the other hand, the internal (firm-specific) factors that inhibit the growth of MSEs include management competency, ‘lack of skilled labor, poor marketing

strategies, innovation level and investments on technology, etc. In this respect, Evans (1987) depicted that firm growth decreases with firm size and age. Others contend that the smallest firms were most vulnerable and that those that grew were less likely to fail than those that did not (Stokes, 2000).

Many important overall policy and institutional reforms have been undertaken including: safety net, decentralization, market economy, agricultural development led industrialization (ADLI), etc. Moreover, a number of sector specific policy reforms and restructuring of regulatory institutions may have contributed to the process of creation of micro and small enterprises. One of the frameworks was related to issuance of the National Micro and Small Enterprises Development Strategy in 1997 and the issuance of Proclamation No. 33/98 to provide for the establishment of the Federal Micro and Small Enterprises Development Agency (Addis ReMSEDA 2009).

The role of Micro and Small Enterprises (MSEs) is indispensable in poverty reduction through employment generation. Cognizant of this, a national MSEs Development Strategy was formulated in 1997. Ethiopia's MSE Policy envisages not only reducing poverty in urban areas but also nurturing entrepreneurship and laying the foundation for industrial development. The strategy was revised in 2010/11 with renewed interests and more ambitious targets on employment and number of entrepreneurs and transition to medium size level (Addis ReMSEDA 2009).

In Ethiopia, a study undertaken by the Central Statistical Agency (CSA) disclosed that there were about 974,679 micro enterprises, generating a means of livelihood for about 1.3 million people (CSA, 2002). Another study conducted in 2003 by CSA also revealed that 1,863 SMEs had created employment opportunities for about 97,782 citizens (CSA, 2003). Study report of FEMSEDA of year 2014 shows there were 8593 Micro Enterprises and 10,061 Small Enterprises in Addis Ababa (FeMSEDA, 2014).

In Ethiopia, MSEs Sector is the second largest employment-generating sector following agriculture (CSA, 2005). According to CSA (2005) the sectors contributes 3.4% of GDP, 33% of the industrial sector's contribution and 52% of the manufacturing sector's contribution to the GDP of the year 2001. In spite of the enormous importance of the micro and small enterprise (MSE) sector to the national economy with regards to job creation and the alleviation of abject poverty in Ethiopia, the sector is facing financial challenges, which impeded its role in the economy. These challenges are lack of access to credit, insufficient loan size, time delay and collateral (Wolday and Gebrehiwot, 2006). Moreover, although MSEs, as compared to their larger counterpart businesses, can create more employment per unit of scarce capital, there are many MSEs which dissolve after a short period of time of their establishment rather than growing. Their dissolution will result in a vicious circle in that they won't be able to take owners out of unemployment, poverty, and economic growth remains weak as the dissolution of an established MSEs is a cost to both regional as well as national level governments.

Objectives of the Review

This paper was written with the general objective of identifying the factors that are responsible to limit the graduation of MSEs from their current state. The specific objectives of this paper are as follows:

- To identify the challenges of MSEs in Ethiopia
- To identify the achievements of MSEs in Ethiopia
- To examine the factors which affect the growth of MSEs in Ethiopia

Methodology

This review was based on common search engines/databases (Google scholar and Science direct) and keywords such as "the challenges of MSEs", "the achievements of MSEs" and, factors affecting MSEs growth". The study reviewed 16 relevant articles on micro, small and medium enterprises. Moreover, pertinent MSEs policy documents from the Federal Micro and Small Enterprises (FMSEs) website, proclamation as well as other research documents relating to MSEs in Ethiopia were reviewed and analyzed. These efforts provided us the information necessary to arrive at some conclusion on the subject matter in Ethiopia.

Literature

Micro and Small Enterprises' Definition

Although many countries around the globe seem to use common factors in their definitions, the degree of emphasis and measures used differ quite considerably. These factors include number of employees, volume of sales, and the capital value of the business. Generally there are two types of definitions. The first is operational definition, which are largely used for working purposes and the other is theoretical definition, which are generally, employed to characterize the sector (Zemenu and Mohammed 2014).

A definition of MSEs in the developed world would differ from how MSEs are defined in the third world. An enterprise categorized as micro enterprise in USA may be treated as medium enterprise in Africa for the fact that the definition of MSE is relative to economic development. The other factor commonly used in defining

MSEs is annual turnover. Again, the acceptable figures differ from country to country, depending among other factors on population and stage of economic development. For example, the accepted definition of small enterprises in USA is “an entity with average annual gross revenues for the preceding three years not to exceed \$15 million, and very small enterprises (Micro enterprises) as an entity with average annual gross revenues for the preceding three years not to exceed \$3 million”. This shows that there is no common definition of MSEs and that the definitions vary from country to country depending largely on the size of the economy, the levels of development, culture and population size of a country involved.

The Ethiopian government defines MSEs based on the size of the capital and level of automation (Solomon, 2004). Accordingly micro enterprises are those small business enterprises with a paid up capital of not exceeding Birr 20,000 and excluding high-tech consultancy firms and other high-tech establishments and Small enterprises are those business enterprises with a paid up capital of above Birr 20,000 and not exceeding Birr 50,000.

In the improved definition of MSEs of Ethiopia (MSE strategy, 2011), Ethiopian Ministry of Trade and Industry and Central Statistical Authority (CSA) define MSEs according to the number of employees and capital. Ministry of Trade and Industry adopted official definition of Micro and a Small enterprise in Ethiopia is as follows.

Table 1: Definition of MSEs according to Ethiopian Trade and Industry Office

Enterprise	Sector	Employee	Capital
Micro-enterprise	Industry	<=5	<= ETB 100,000.00
	Service	<=5	<= ETB 50,000.00
Small-enterprise	Industry	6-30	<= ETB 1.5million
	Service	6-30	<= ETB 500,000.00

Source: Ethiopian Micro and Small Enterprises Strategy (2011)

Results of previous studies

Globally, Ethiopia stands at 150 in the ranking of 183 economies on the ease of getting credit (Doing Business Ethiopia, 2012). According to World Bank group (2017) Ethiopia scored 161 out of 190 (where a score of 1 stands for most business friendly regulations).

Factors contributing to failure of MSEs

Various studies have been conducted outside Ethiopia to describe the challenges and opportunities of MSEs resulting in the following lists.

No.	Country/Region	Challenges	Opportunities
1.	Brazil Claudino et. al, 2017	Absence of qualified personnel	Management support
		Fear of innovation consequences	Planning of actions required for implementation
		Entrepreneurs and employees' conformism	
2.	Bulgaria SMEs (EU member) Ahmedova, 2015	Identifying customers	ICT
		Access to finance	
		Low innovation as experienced by low intellectual property registration	
		Low international trade	
3.	Ghana Ackah & Vuvor, 2011	Lack of credit facility	
4.	Sub-Saharan Africa Mamman et. al, 2018	Corruption	
		In-coherent SME policies	
		Misallocation of resources	
		Bureaucracy and inefficiency	
		Hampering the ease of starting a new business	
		Inadequate or a lack of assistance in terms of mentorship to support entrepreneurship	
		very scarce protection of the SMEs	
		There is a focus on the supply side of entrepreneurs paying a very limited attention to what the economy seems to be demanding	
		Entrepreneurs orientation (because of the tendency to attribute success to external factors such as supernatural powers or ancestors, business decisions are not always influenced by economic rationality	
		limited or no financial aid	
		The physical and institutional infrastructural deficit (rent seeking behavior, trust among stakeholders)	
		Entrepreneurship training assumptions that are direct copies of western assumption	

From the above table we can understand that lack of capital or credit access is not the first prioritized challenge except for Africa. This is mainly because of the economic development of European Union members and South America compared to that of Africa.

Challenges and Opportunities facing MSMEs in Ethiopia

Looking at the Ethiopian scenario, we found studies having similar challenges with few exceptions and little/no opportunities.

Given their role and the attention they took, the performance of MSMEs in Ethiopia has not been satisfactory. The level and quality of MSME employment is still a concern (Solomon Tarfasa et al., 2016); large and older firms are still the important sources of net new jobs than small and younger firms (World Bank, 2015).

Using the 2011 Enterprise Survey data, WB (2015) identified that almost half of microenterprises, 40% of small firms, and 18.5% of medium firms reported access to finance in Ethiopia to be a major constraint to daily operations.

In Ethiopia women owned enterprises are challenged by bad price for the product and service/selling at less price compared with other similar enterprises, shortage of raw material and lack of experience in own business were challenging factors for women entrepreneurs" (Tadesse Demeke, 2016). In another study conducted by Singh & Belwal (2008), Ethiopian Women owned MSEs faced challenges that can be described as lack of capital, limited access to markets, to network, to premise, lack of training and cultural oppressions.

Another study in Ethiopia conducted by Hagos Yared (2012) revealed that high competition as a result of open entry to the business affected newly born MSEs. Besides, the country's development strategy and policy focusses on agriculture which in turn discourage MSEs operating in other sectors.

Region wise various studies were conducted and provided plenty of challenges. According to Yonas Abera (2016) unfair practices, unattractive market, lack of advertisement and market linkage were identified as market challenges of MSEs in Diredawa city administration. In a survey conducted by FDRE Ministry of Urban Development and Construction (2013) SMEs in Addis Ababa were challenged by lack access to finance, premises and training.

In Hawassa city the major challenges facing SMEs were shortage of electricity and unscheduled power cuts, market access, lack of selling premises, Insufficient credit facility and bureaucratic working procedure (Bereket Teklehimanot, 2017).

According to Berhanu et. al (2015) MSEs in Gedeo Zone were challenged by high tax, high collateral requirement, bureaucratic burden, lack of credit access, inefficient tax administration, high interest rate and lack business premises.

In another study Desalegn Berhane (2016) found that MSEs in Tigray faced Low infrastructure, lack of technology, weak performance leading to absence of growth thinking challenges. Similarly, Zemenu A. and Mohammed M. (2014) revealed that MSEs in Mekelle City suffered from intensive competition, inadequate credit facility, starting business without conducting survey, inappropriate tax imposition, inappropriate tenure, lack of business training, shortage of working capital, absence of appropriate technology, uncollectible receivables and lack of financial management skill. These challenges led the enterprises to dissolve early rather than growing.

According to Belay et. al (2015) lack of finance, Youth's adverse attitude towards working under umbrella of MSEs agency and failure of Zonal MSE agency to serve as broker between MSEs and other supporting institutions were the major challenges.

With regard to the opportunities of MSEs, Tadesse Demeke (2016) revealed that business consultation services, premises, training for the beginner, loan facilities, moral or encouragement, peace and security, area specific features, support and reward like training, fund, and certificate play a role for expansion and growth of women entrepreneurs in particular and MSE owners in general.

Additionally, MSEs are allowed to participate in government bid without providing CPO, however many of them disappear when they are approved to provide the materials. Besides, MSEs are given chance to take government projects as a contractor or sub-contractor that will make them beneficiary.

Factors Affecting Growth of MSEs in Ethiopia

Although several challenges inhibit the growth of MSEs, the critical problem is damaging rent-seeking behaviors, which are manifested in different forms. Other challenges that undermine the growth of MSEs are access to technology, skills, capital financing and markets" (FDRE MUDC, 2016).

The NBE directive no. SBB/53/2012 restricts commercial banks to go beyond 25% of their capital for single borrower and 15% of their total capital for a related party. Similarly, the NBE directive no. MFI/18/06 limits MFIs not to go beyond 1% of their capital for individuals who can provide collateral and not more than 4% of their capital for group collateral. These lending restrictions were imposed on private banks and then replaced by an NBE directive (MFA/NBE Bills/001/2011) which obliges commercial banks to allocate 27% of total loan disbursed during the month for the purchase of low interest bearing NBE bills. The NBE bill purchase requirement continues to severely constrain private commercial bank operations which in turn results in favoring existing, established clients when allocating loans as opposed to newer, riskier SMEs " (Fredu Nega and Edris Hussein.2016).

Belay et. al (2015) found that Lack of water supply, reliable power supply, transportation facilities (infrastructure challenges), interest rate, lack of access to information on business opportunities, absence of state-of-art machinery and equipment, business skill gaps, youths' negative attitude toward working in MSE and consumers perception of MSE's product as poor quality were factors that hindered MSEs growth in Gore town.

Despite the presence of strategies that aim to support MSEs, the enterprises are weakly performing. Supporting this, ECA (2001) concluded that countries such as Cameroon, Ethiopia, Gabon, Nigeria, Senegal and Uganda have shown that the policy environment in which MSEs operate proves to be a major handicap for their expansion and growth. Besides, the complexity of the customs system and the many forms and declarations required have had a negative impact on the general business climate, diverting entrepreneurs' efforts from more productive tasks.

Conclusion

The level and quality of MSMEs employment is still a concern in Ethiopia mainly because they fail within short period of time. The prominent challenges listed in various studies in Ethiopia are access to finance, selling at less price compared with other similar enterprises, shortage of raw material, lack of experience in own business, limited access to markets, to premise, lack of training, cultural oppressions, high competition as a result of open entry to the business, development strategy and policy focusses on agriculture which in turn discourage MSEs operating in other sectors, unattractive market, lack of advertisement challenged by lack access to finance, premises, training. shortage of electricity and unscheduled power cuts, insufficient credit facility, bureaucratic working procedure, high tax, high collateral requirement, high interest rate, lack of technology, weak performance leading to absence of growth thinking challenges, starting business without conducting survey, inappropriate tenure, lack of business training, uncollectible receivables, lack of financial management skill and

Youth's adverse attitude towards working under umbrella of MSEs agency.

On the opportunity side, studies revealed few of them including business consultation services, premises, training for the beginners, loan facilities, moral or encouragement, peace and security, area specific features, support and reward like training, fund, and certificate play a role for expansion and growth of women entrepreneurs in particular and MSE owners in general. Additionally, MSEs are allowed to participate in government bid without providing CPO, however many of them disappear when they are approved to provide the materials. Besides, MSEs are given chance to take government projects as a contractor or sub-contractor that will make them beneficiary.

With regard to the growth related challenges faced by MSEs, several challenges inhibit the growth of MSEs. Some of them are damaging rent-seeking behaviors, access to technology, skills, capital financing, markets, highly regulated financial institutions, lack of infrastructure, interest rate, lack of access to information on business opportunities, absence of state-of-art machinery and equipment and business skill gaps.

Policy Implications and Future Direction

Many of the MSMEs in sub-Saharan African countries are characterized by low innovation leading to lack of growth initiation. Besides, lack of finance as a result of highly regulated financial system discouraged MSMEs in Ethiopia. Thus, the reviewers recommend the following for policy makers and other stakeholders.

It is advised for policy makers to revise policy and strategy of Ethiopia so that MSEs in all sectors will get support indiscriminately and they will get more chance of credit facility. Higher government officials should also facilitate fair institutional and physical infrastructure that can motivate MSEs in the country.

Another important notion is training assumption for MSEs. In this regard, MSE agencies and consultants should tailor training sessions for MSEs in different regions contextually and in line with survey results in respective regions. This is because lack of business skill might be a priority in one region and lack of premise might be top priority in another region.

With regard to funding MSEs, Ethiopian government should revise the tight regulation of financial institutions so that MSEs will have equal and fair funding sources like their large counterparts. In fact, the risky nature of MSEs in the country may pose a problem but if the physical and institutional infrastructures along with indiscriminate support for all MSEs is guaranteed the enterprises will have attractive performance and loan repayment capacity.

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